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2011 ANNUAL REPORT



Xerium Technologies, Inc.
8537 Six Forks Road, Suite 300
Raleigh, NC 27615

Stephen R. Light
Chairman, President & Chief Executive Officer

April 27, 2012

My fellow shareholders,

As I write my fifth annual shareholder letter, I am struck by the unusual complexity we witnessed in the global economy and consequently, in the global paper industry in 2011. During the early portion of 2011, the global economy appeared to have stabilized from the recession in 2009 and the rebound in 2010, and there were at least a few reasons for optimism. As we looked around the world in the spring of 2011, we saw Asia growing strongly while North America was still fighting high unemployment and a no-growth housing market but not contracting any longer. In addition, European economies were stable with just a few rumors about Greek debt beginning to surface and South America, primarily led by what would prove to be an overheated Brazilian economy, growing quickly. As the US and Chinese auto industries strengthened, oil prices began a rapid ascent, rising from approximately \$70 USD to over \$100 USD per barrel. Our customers were busy ordering products from us to replenish deeply reduced inventories and their spirits were high.

The paper producers began the year very strong with forecasted tonnage growth of nearly 4%, according to RISI, one of the global forecasting organizations we use for planning purposes. This above long term trend growth rate was spurred by expectations of nearly 6% growth in Asia, 1% growth in Europe, flat in North America, and approximately 5% growth in South America. Unfortunately, as we experienced during the second half of 2011, these forecasts proved to be too optimistic.

By mid-year, all regions except North America saw paper production tonnage expectations drop precipitously. The European economic crisis brought out the most conservative production planning we've seen since late 2008. Paper producers slowed production and consequently orders for the products we produce slowed as well.

Weaker companies were sold to larger ones, consolidation shuttered paper mills and a broad malaise spread across the industry on the European continent. Paper companies who had been rebuilding their PMC inventories halted that process and delayed needed roll covering investments. In South America, hampered by the strength of the Brazilian Real, exports plummeted while inflation reached 6.2%, quickly making production there unacceptably expensive. Asian producers, primarily those in China, slowed production as the Chinese central planners attempted to slow overall growth to dampen rising inflation. This slowing production and parallel inflation resulted in slowing demand for our products and increased our internal costs. Offsetting all of these challenges, the North American paper industry showed remarkable strength and increased tonnage above expectations. Partially driven by currency exchange rates which facilitated exports to Europe, Eastern Canadian newsprint producers enjoyed a terrific year, as did all North American tissue producers.

These market dynamics caused us to view the year as two periods, the first portion expansion driven, the second contraction and cost reduction focused. The agility of our management team to make this rapid adjustment enabled us to make measurable progress toward our long term goals, but below expected performance for 2011.

We made progress in nearly every operating metric including: refinancing our entire debt structure, market share growth, new product introduction, labor productivity, sales per employee, customer loyalty, weaving yield improvements, press felt capacity expansion, forming fabric line of balance process implementation, emerging market penetration, debt reduction, and organization skills upgrading.

- Refinancing our entire debt structure was accomplished in the second quarter of 2011 at the year's most optimal time in the credit market. Today, we have an entirely new structure more suitable to a company in our market, which includes a six year term loan and seven year bonds. Additionally, we simplified the covenants of the loans so that as conditions evolve in our markets we can adjust accordingly. To assure we are protected against abrupt changes in the LIBOR rate, we subsequently purchased an interest rate cap on the rate giving us increased interest rate security over the life of the term loan.
- Market share gains were realized in North America and Asia. In North America, our market share gains were sufficient to more than offset the overall contraction in forming fabric consumption such that we actually increased our forming fabric output and sales. In press felts, we grew at nearly three times the increase in market demand. In Asia, sales grew at nearly 20% as a result of successes in our Total Clothing Management (TCM) process in which we engineer and provide all the clothing used on a specific paper machine. Additionally, we increased sales of roll products in China with the creation of a spreader roll rebuilding capability. Establishing this new capability was a joint effort of our European and Asian roll units and should increase our roll business market share.
- New product introductions continued the pace of the past few years as we move forward on our quest to achieve at least 60% of our revenue from sales of new products which we define as products introduced to the market in the prior five years. In many regions, specific products are well over the 60% goal already. Leading this advance are Finetexx, a new forming fabric targeted at the very large fine paper and tissue markets, and Impact, our non-woven press felt product, which continues to expand its penetration. SmartRoll™ received its 200th order before the end of 2011, and approximately 175 SmartRolls™ have been delivered to paper machines in every global region. SmartRolls™ are now in use on every grade of paper from packaging to tissue. More versions of this exciting product are in development for future deployment.
- Labor productivity, as measured by sales per employee, increased 4.5% as our factory teams executed countless small and large projects to reduce idle time and to speed the flow of products through our plants. The year-end productivity results were somewhat dampened in the fourth quarter when we decided to prevent an inventory build up by shuttering many of our facilities when our European customers stopped ordering products to conserve cash. Factory employee contribution to making Xerium a better company can best be exemplified by this year's Chairman's Innovation Award winning factory team from our Kentville, Nova Scotia forming fabric factory who won their award for a productivity breakthrough in material handling which contributed to that plants' success in 2011.
- Weaving yield improvements continued to be the center of focus at our factories. Dryer yields approached 70% and forming yields reached the mid 60% range. Contributing to this continued improvement is the company's new proprietary scheduling simulation software, the globalization of our product designs which enable the same product of differing widths to be produced at the most optimal location, and investments in new weaving equipment whose breakthrough technology is making a step function change in our factory planning. Press felt capacity expansion, in which we have invested heavily in order to meet new product demand, was essentially completed late in 2011. With these investments in our global facilities, we have increased our overall press felt capacity by nearly 25%. We were able to accomplish this increase without balance sheet damaging capex by capitalizing on our harmonized product designs, and on our new non-woven press felt product, "Impact" which we introduced in 2010. Today we believe we have matched our press felt capacity and products with global demand development for the next several years.
- Forming fabric line of balance process implementation was key to realizing the labor productivity we achieved in our forming plants. Our line of balance process focuses our plant management on achieving uniform flow through their plants and minimizes work in process inventories in order to reduce order to delivery lead times and highlight any process issues quickly. Implemented in early 2011 in our Kentville facility, and being rolled out across the company, we achieved a nearly 40% productivity improvement, as

measured by square meters of forming fabric production per employee, in that plant, while reducing in process inventory by 30%. We believe that the resulting reduction in customer order to delivery lead time facilitated much of our market share gain in North America.

- Emerging market penetration continues to be a major focus of the company, as there is no question that the growth of paper production in the emerging markets is driving overall global production and will continue to do so for many years to come. Today, Asia is the largest paper producing region as measured by tons of paper manufactured. Our growth there is testimony to the focus we have applied to building a customer support network including sales and service personnel. Buoyed by our TCM process, we believe we are well positioned to continue to expand our presence in the region.
- Debt reduction remains the center piece of our operating cash flow strategy. In 2011 we made payments to reduce debt by \$14.0 million. During the first quarter of 2012, we made another \$13.2 million in payments to reduce debt. While our debt will continue to fluctuate based on the Euro to US dollar exchange rates, we are pleased with our progress in this area.
- Organization skills upgrading, a critical element in our overall strategic planning, made good progress in 2011. We successfully recruited and brought onboard a new CFO who brought relevant experience immediately to the company. We upgraded more than half of our plant managers, and many of our other operational and financial team members. We added an excellent new Director to our Board and celebrated the retirement of our longest serving member.

But offsetting this very solid operational progress, and largely consuming all the savings we generated through this work, were extraordinary increases in key raw material costs, driven by expanding markets for (i) oil, which is the raw material for the yarns we use in our paper machine clothing products, (ii) natural and synthetic rubber which we use in our roll covers, and (iii) specialty steels which we use in our spreader roll products. Raw materials constitute approximately 30% of our cost of goods sold. Oil prices increased from approximately \$70 per barrel to approximately \$100 per barrel. Rubber increased 14.7% costing Xerium \$4.2 million, while specialty steel costs jumped 7.3%.

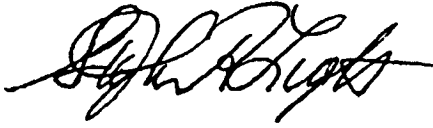
Owing to the dramatic increase in our weaving yields I mentioned earlier, we were largely able to offset the increases in yarn costs until the fourth quarter of 2011 when our reduced production did not fully absorb our fixed overheads. Early in 2012 we've seen some easing of rubber and steel prices but no easing of oil related product prices. Our long term contracts with customers protect us from only a portion of these price increases.

It also proved difficult to pass along our increased raw material costs to our customers, many of whom are on long term supply agreements with us. Fortunately our analysis shows that many of our new products favorably impact our sales prices and margins, hence our continued zeal in this area. We expect 2012 to have a more favorable pricing environment in most regions as the global economy improves through 2012.

As we look forward into 2012, we expect to see a slowly improving global economy beginning in the second half which should contribute to increasing paper production and demand for our products. As our factories are very capital intensive, sales volumes are the key to absorbing our fixed overheads. But the cyclical nature of our served markets makes agility in capacity and fixed cost management a critical skill and one we are working to optimize in 2012. We will continue to seek means to reduce our fixed cost investment and to optimize our overall production capacity to closely match the market dynamics we experience. Our focus on overall productivity will remain a ceaseless mantra as dictated by the evolving nature of our customers, their products, and our shareholders. Combined, these cost reduction efforts will take us to our next performance level.

I am quite optimistic about the long term prospects for Xerium's business because our new products and market engagement are creating exceptional levels of customer loyalty, our new capital structure provides us increased flexibility to manage our affairs through the industry's cycles, and our organization's skills and engagement are continuing to improve. I am also optimistic that as 2012 progresses to our expectations, the market will appreciate the improvements we have made along our strategic path.

Sincerely,

A handwritten signature in black ink, appearing to read "Stephen R. Light". The signature is fluid and cursive, with the first name "Stephen" being more prominent than the last name "Light".

Stephen R. Light

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2011

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the transition period from

to

Commission File Number 001-32498

Xerium Technologies, Inc.

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation or organization)

42-1558674

(I.R.S. Employer Identification No.)

8537 Six Forks Road, Suite 300
Raleigh, North Carolina 27615
(Address of principal executive offices)

(919) 526-1400

Registrant's telephone number (including area code)

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock, \$0.001 par value per share	New York Stock Exchange
Preferred Stock Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☒ No ☐

The aggregate market value of the voting common stock held by non-affiliates of the registrant on June 30, 2011 was approximately \$148,171,445. There were 15,154,922 shares of the registrant's common stock, \$0.001 par value per share, outstanding as of March 02, 2012.

DOCUMENTS INCORPORATED BY REFERENCE

Proxy Statement for the 2012 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14A, is incorporated by reference in Part III to the extent described therein.

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CAUTIONARY STATEMENT FOR PURPOSES OF THE “SAFE HARBOR” PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Annual Report on Form 10-K contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 that are subject to the safe harbor created by that Act. These statements relate to future events or to our future financial performance and involve known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by these forward-looking statements. In some cases, forward-looking statements can be identified by the use of words such as “may,” “could,” “expect,” “intend,” “plan,” “seek,” “anticipate,” “believe,” “estimate,” “predict,” “potential,” or “continue” or the negative of these terms or other comparable terminology. Undue reliance should not be placed on forward-looking statements because they involve known and unknown risks, uncertainties, and other factors that are, in some cases, beyond our control and that could materially affect actual results, levels of activity, performance, or achievements. Factors that could materially affect our actual results, levels of activity, performance or achievements include the following items:

- we are subject to the risk of weaker economic conditions in the locations around the world where we conduct business, including the impact of price pressures and cost reduction strategies by our customers in the paper industry;
- our strategies and plans, including, but not limited to, those relating to developing and successfully marketing new products, enhancing our operational efficiencies and reducing costs, may not result in the anticipated benefits;
- we may be required to incur significant costs to reorganize or restructure our operations in response to market changes in the paper industry;
- our financial results could be adversely affected by fluctuations in interest rates and currency exchange rates;
- our manufacturing facilities may be required to quickly increase or decrease production capacity, which could negatively affect our production, customer order lead time, product quality, labor relations or gross margin;
- we may not be successful in developing and marketing new technologies or in competing against new technologies developed by competitors;
- variations in demand for our products, including our new products, could negatively affect our net sales and profitability;
- we are subject to fluctuations in the price of our component supply costs;
- due to our high degree of leverage and significant debt service obligations, we need to generate substantial operating cash flow to fund growth and unexpected cash needs;
- our credit facility contains restrictive covenants, such as the covenants requiring compliance with minimum interest coverage and maximum leverage ratios, which become more restrictive over time, that may require us to increasingly improve our performance over time to remain compliant;
- we are subject to the risk of terrorist attacks or an outbreak or escalation of any insurrection or armed conflict involving the United States or any other country in which we conduct business, or any other domestic or international calamity, including natural disasters;
- we are subject to the impact of changes in the policies, laws, regulations and practices of the United States and any foreign country in which we operate or conduct business, including changes regarding taxes and the repatriation of earnings; and
- anti-takeover provisions could make it more difficult for a third-party to acquire us.

Other factors that could materially affect our actual results, levels of activity, performance or achievements can be found in our “Risk Factors” section in this Annual Report on Form 10-K. If any of these risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary significantly from what we project. Any forward-looking statement in this Annual Report on Form 10-K reflects our current views with respect to future events and is subject to these and other risks, uncertainties, and assumptions relating to our operations, results of operations, growth strategy, and liquidity. We assume no obligation to publicly update or revise these forward-looking statements for any reason, whether as a result of new information, future events, or otherwise, except as required by law.

All references in this Annual Report to “Xerium”, “the Company”, “we”, “our” and “us” means Xerium Technologies, Inc. and its subsidiaries.

PART I

ITEM 1. BUSINESS

General

We are a leading global manufacturer and supplier of two types of consumable products used primarily in the production of paper—clothing and roll covers. We market our products through the following industry-recognized brands:

<u>Brand</u>	<u>Product Category</u>	<u>Geographic Region</u>
<i>Huyck Wangner</i>	Clothing	Worldwide other than North America
<i>Weavexx</i>	Clothing	North America
<i>Stowe Woodward</i>	Roll Covers & Spreader Rolls	Worldwide
<i>Mount Hope</i>	Spreader Rolls	Worldwide
<i>Robec</i>	Spreader Rolls	Europe
<i>Xibe</i>	Roll Covers	China

As of December 31, 2011, we have an extensive global footprint of 31 manufacturing facilities in 14 countries, strategically located in the major paper-producing regions of North America, Europe, South America and Asia-Pacific, and have 3,448 employees worldwide. We market our products, primarily using our direct sales force, to the paper industry's leading producers. In 2011, we generated net sales of \$587.0 million.

Company Overview

Our clothing and roll cover products are installed on pulp and paper-making machines and play key roles in the process by which raw materials are converted into finished paper. A fundamental characteristic of our products is that they are consumed in the paper production process and must be regularly replaced. This positions us to make recurring sales to our customers, and accordingly the number of paper machines in operation throughout the world and the amount of paper, pulp and board produced globally each year are primary drivers of the demand for our products. In addition, our products are also installed in other industrial applications such as nonwoven and fiber cement machines.

Paper-making machines utilize different processes and have different requirements depending on the design of the machine, the raw materials used, the type of paper being made and the preferences of individual production managers. We employ our broad portfolio of patented and proprietary product and manufacturing technologies, as well as our extensive industry experience, to provide our customers with tailored solutions designed to optimize the performance of their equipment and dramatically reduce the costs of their operations. We systematically track and report the impact of these customized solutions to our customers through our ValueResults program which quantifies the optimization process on their machines.

Our clothing products are highly engineered synthetic textile belts that transport and filter paper as it is processed in a paper-making machine. Clothing plays a significant role in the forming, pressing and drying stages of paper production. Our clothing segment represented 66% of our net sales for each of the years ended December 31, 2011, 2010 and 2009.

Roll cover products cover the rolls on a paper-making machine, which are the large steel cylinders over which clothing is mounted and between which the paper travels as it is processed. Our roll covers provide a surface with the mechanical properties necessary to process the paper in a cost-effective manner that delivers the sheet qualities desired by the paper producer. We currently use several hundred chemical compounds in our roll cover manufacturing process. Our roll cover segment represented 34% of our net sales for each of the years ended December 31, 2011, 2010 and 2009.

Our products are in constant contact with the paper during the manufacturing process. As a result, our products have a significant effect on paper quality and the ability of a paper producer to differentiate its products, two factors which are increasingly important to paper producers. In addition, while clothing and roll covers represent only approximately 3%, on average, of a paper producer's production costs, they can help a paper producer improve productivity and reduce overall costs. Our clothing and roll covers facilitate the paper producer's use of less expensive raw materials (including recycled fiber), their ability to run paper-making machines faster and with fewer interruptions, and their ability to decrease the amount of energy required in the expensive drying portion of the paper-making process. We have found that, in certain cases, our products and services provide paper producers with cost savings that substantially offset the costs of such products and services.

We estimate that there are approximately 7,000 paper-making machines worldwide, all of which require a regular supply of clothing and roll covers. Clothing and roll covers must be replaced regularly to sustain high quality paper output and operate efficiently. Roll covers also require regular refurbishment, a service that we provide to our customers. Paper producers typically replace clothing several times per year, replace roll covers every two to five years and refurbish roll covers several times between each replacement.

We have a reputation for technological innovation in the paper-making industry. In our clothing segment, in recent years we have focused our research and development efforts on higher value-added, technologically advanced products, such as forming fabrics and press felts, which offer paper producers greater potential for differentiating their products through quality improvements and increasing their operating efficiency. We pioneered a number of technologies that have become industry standards, including in our clothing business, synthetic forming fabrics (which replaced bronze wire technology), double-layer forming fabrics, laminated press felts and, most recently, triple-layer forming fabrics.

In our roll covers segment, we have introduced a number of innovations to our roll cover and spreader roll products in recent years, including SmartRoll™, the first continuous pressure sensing paper machine roll that enables the papermaker to maximize performance by knowing the pressure of the paper machine while the machine is running, shoe press belts which utilize our expertise in polyurethane material and manufacturing technologies, composite calender roll covers that use nanoparticle technology to improve roll cover durability and paper gloss, as well as covers that use an improved polyurethane to increase abrasion and moisture resistance as well as responsiveness and stability.

Our portfolio of patented and proprietary product and manufacturing technologies differentiates our product offerings from others in the market and allows us to deliver high value products and services to our customers. As of December 31, 2011, we had approximately 280 issued patents and approximately 105 pending patent applications. We currently license certain of our patents and technologies to some of our competitors, which we believe helps further demonstrate our technological leadership in the industry. We believe that the technological sophistication of our products and the capital-intensive nature of our business present significant challenges to any potential new competitors in our field.

Our business was organized in 1999 in connection with the acquisition of the paper technology group of Invensys plc. We completed our initial public offering on May 19, 2005.

Chapter 11 Filing, Emergence and Plan of Reorganization

On March 30, 2010, we and certain of our subsidiaries filed voluntary petitions for relief under Chapter 11 of Title 11 of the United States Code, 11 U.S.C. §§ 101-1532, in the United States Bankruptcy Court for the District of Delaware. On May 12, 2010, the Bankruptcy Court entered an order confirming the plan of reorganization ("the Plan"). On May 25, 2010, the Plan became effective and we and our subsidiaries emerged from Chapter 11. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Chapter 11 Filing, Emergence and Plan of Reorganization" for additional information regarding our Chapter 11 proceedings.

Recent Developments

Global Economic Environment

Our operations are highly dependent upon the pulp and paper production industry and the degree to which the paper industry is affected by global economic conditions and the availability of credit.

Beginning in 2008 and continuing through most of 2009, the global paper industry experienced a sharp reduction in production levels, caused by the general slowdown in economic activity and related paper consumption during the same period and the paper manufacturers' reduction of excessive inventories. The slowdown of production was across most grades of paper production, but most notably in packaging and newsprint grades. For packaging grades, demand was directly related to broad manufacturing and transportation activity reduction, while newsprint demand has been declining over a number of years due to the greater prevalence of electronic media and was exacerbated during the recession by a reduction in print advertising. One of the results of this recession driven reduction in demand for paper products was that the paper manufacturers dramatically and quickly reduced production through curtailments of machines and complete mill shutdowns. These curtailments, which began in late 2008, served to reduce inventories and match output with demand. By early 2010, most mills and equipment not permanently shuttered had resumed production.

In the first half of 2011, global paper and board production continued the recovery that began in 2010, particularly in developing countries. As international shipments of manufactured goods increased, containerboard production recovered particularly strongly, contributing over 50% of the total global improvement. The paper and board production recovery stalled in the second half of 2011, particularly in Europe and South America. In the near term, we expect that global paper and board manufacturers' operating rates will remain near their second half 2011 levels. As a result of these factors, pricing pressures increased as 2011 progressed. We have endeavored to maintain our current pricing levels in both our clothing and rolls segments.

Business Strategy

The primary components of our business strategy are:

Fiscally Responsible Management. We are committed to improving our capital structure and creating sufficient financial flexibility. This will allow us to continue to invest in our operations where we can expect reasonable returns, expand into markets where our products and services will create value for our customers and support the global growth of the paper-making industry. As part of this strategy, our focus on the reduction of working capital, allocation of capital investments and elimination of loss-making businesses, customers and products will drive our activities. We may incur additional operational restructuring expenses in connection with pursuing cost-savings opportunities. We believe that our potential to improve productivity includes the opportunities to enhance our manufacturing efficiency by improving our process yields and reducing our cycle times.

New Product Development. We are committed to maximizing our margins and profitability in both our clothing and roll covers segments by focusing our production and marketing efforts on higher value-added, technologically advanced products that will benefit our customers by providing them with the cost savings and quality improvement characteristics they require to be competitive. We intend to continue to offer a full range of product offerings in order to meet our customers' needs. We believe that the development and successful introduction of new products in a systematic and customer-focused manner will allow us to meet the expected demands of global market growth and our own sales growth and profitability projections. Simultaneous standardization and simplification will help us achieve significant cost reductions and competitiveness.

Workforce Engagement. We are committed to alignment of objectives for our entire workforce. We believe that communication, training, tools and incentives associated with this alignment are essential to meeting our business plans and objectives. Human resource management systems must be in place in support of this strategy,

including retention of personnel to maintain and enhance the quality of the performance of our workforce, visibility to career opportunities to create job growth, and incentive systems that reward the workforce for achievement of critical objectives. Our approach includes the “high-grading” and “right-sizing” of our workforce to make certain those individuals most necessary for our success are in a position to positively contribute to goal achievement.

Products

We operate through two principal business segments, clothing and roll covers. Our clothing segment products include various types of industrial textiles used on paper-making machines and other industrial applications. Through our roll covers segment, we manufacture various types of roll covers, refurbish previously installed roll covers, provide mechanical services for the internal mechanisms of rolls used on paper-making machines and manufacture spreader rolls. For additional financial information about our clothing and roll covers segments, please see “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Note 15 to the accompanying audited consolidated financial statements.

Clothing Products

Our clothing segment products are large, highly engineered synthetic textile belts that transport paper as it is processed in a paper-making machine from paper stock into finished paper. Clothing products must be tailored to each machine because all paper-making machines have different physical configurations and operating parameters. Clothing generally ranges in size from approximately 7 feet to over 30 feet wide and 24 feet to more than 460 feet long and operates on paper-making machines that run at speeds up to 7,500 feet per minute. We typically sell clothing products for between \$13,000 and \$45,000 per belt, although we sell some of our more sophisticated forming fabrics for up to \$200,000 per unit.

We manufacture three general types of clothing products used on paper-making machines—forming fabrics, press felts and dryer fabrics—each of which is located in a different section of a machine. Forming fabrics and press felts are typically replaced several times a year, but replacement frequency varies significantly by the grade of paper being produced, the manner in which the paper-making machine is operated and the quality of raw materials used in the paper stock. Dryer fabrics are replaced less frequently, with replacement typically taking place no more than once per year.

Forming fabrics. Forming fabrics are used at the beginning of paper-making machines, where highly diluted paper stock is deposited on the forming fabric while the fabric is traveling at a very high speed. Forming fabrics allow water to drain from the paper stock, creating an initial wet sheet. Forming fabrics must be sufficiently porous to allow water to drain evenly and quickly, yet tight enough to retain and align the fiber and other materials that form the sheet of paper. They must also be strong enough to withstand high mechanical stresses. Forming fabrics are custom-manufactured in single, double, and triple layer designs in a variety of meshes to suit particular machines and paper grades. Customers are increasingly demanding the higher-priced triple layer designs that remove more moisture and produce higher quality paper. In 2011, forming fabrics accounted for approximately 41% of net sales in our clothing segment.

Press felts. Press felts are used to carry the paper sheet through a series of press rolls that mechanically press water from the sheet under high pressure. Press felts are designed to maximize water removal, which reduces the amount of water that must be removed during the expensive energy-intensive drying section of the production process. Press felts must maximize water removal while maintaining the orientation of the fibers and the consistency of the thickness of the paper, without removing chemicals or fillers from the paper.

Press felts differ from forming fabrics and dryer fabrics due to the addition of several layers of staple fiber that are needled into the fabric base. The staple fiber provides a smooth surface to meet the wet sheet of paper and creates a wicking effect to remove water from the paper sheet as it is pressed under high pressure between

press rolls. Press felts are manufactured in a variety of designs, including lightweight single layer felts, multi-layer laminated endless felts and seamed felts that allow for reduced installation times. In 2011, press felts accounted for approximately 41% of net sales in our clothing segment.

Dryer fabrics. Dryer fabrics are used to transport the paper sheet through the drying section of paper-making machines, where high temperatures from large, steam-heated dryer cylinders evaporate the remaining moisture from the paper sheet. Dryer fabrics, which are less technically advanced than forming fabrics or press felts, are woven from heat-resistant yarns with a coarser mesh than forming fabrics. In 2011, dryer fabrics accounted for approximately 6% of net sales in our clothing segment.

Industrials and Other. We manufacture other fabrics used in other industrial applications, such as pulp, steel, plastics, leather and textiles manufacturing. In 2011, net sales for such industrial applications accounted for 11% of net sales in our clothing segment. We also manufacture auto-joining equipment used in clothing production. Net sales of auto-joining equipment accounted for less than 1% of net sales in our clothing segment in 2011.

New Clothing Products. In recent years, we have focused our research and development efforts on higher value-added, technologically advanced products, such as forming fabrics and press felts, which offer paper producers the greatest potential for differentiating their products through quality improvements and for increasing their operating efficiency. Our research and development efforts have resulted in several innovative new forming fabric and press felt products, including a number of high performance products, such as triple layer forming fabrics, for use on high performance paper-making machines. In addition, we have developed new clothing products aimed at segments of the paper-making process that we have not historically served, such as the growing market for shoe press belts and other clothing products designed for use in the technologically-advanced press section of a paper-making machine.

Roll Covers Products and Services

In our roll covers segment, the majority of our sales are generated through the manufacture of roll covers. We also refurbish previously installed roll covers, provide general mechanical maintenance and repair services for the internal mechanisms of rolls and manufacture spreader rolls.

Roll covers. We manufacture, refurbish and replace covers for three kinds of rolls on paper-making machines: working rolls (including vacuum rolls and press rolls), calendar rolls and coater rolls. There can be up to 200 such rolls in a typical paper-making machine. These metal rolls, which can be up to 39 feet long, 6 feet in diameter and weigh 500 to 140,000 pounds, are covered with an exterior layer of rubber, polyurethane, composite or ceramic, each of which is designed for use in a particular phase of the paper-making process. Roll covers operate in temperatures up to 400 degrees Fahrenheit, under pressures up to 1,400 pounds per square inch and at speeds up to 7,500 feet per minute. Roll covers are typically replaced every two to five years.

Roll cover replacement is performed at the manufacturing facility of the supplier, such as Xerium, which necessitates removing the roll from the paper-making machine, transporting it to the supplier's site and using a spare roll in the interim. In general, each roll on a paper-making machine is unique due to its dimensions, specific design and cover material, and generally not interchangeable with other rolls. Because of their large size, paper producers generally maintain only one spare roll for each position on a paper-making machine. It is important that the roll cover replacement be completed quickly, because damage or a malfunction of the spare roll could render the paper-making machine inoperable.

Due to the large size and weight of a roll, transportation to and from a supplier's site can be costly and is occasionally subject to regulations on road use that restrict available routes and times of travel, and that may require safety escorts. Round-trip transcontinental travel can take several weeks and intercontinental travel is rare. We offer an extensive network of manufacturing facilities worldwide, often in close proximity to our customers, which we believe is a significant competitive advantage.

We typically sell roll covers for between \$1,000 per roll (*e.g.*, for a small installed rubber roll cover) and \$300,000 per roll (*e.g.*, for a large installed polyurethane cover). Net sales of roll covers accounted for approximately 55% of our total net sales in our roll covers segment in 2011.

Roll Cover Refurbishment Services and Mechanical Services. Roll covers are typically refurbished several times over the two to five years they are in service before needing to be replaced. Refurbishment typically includes the regrinding of the roll cover to standard specifications and inspecting the bearings and other mechanical components of the roll. As with roll cover replacement, refurbishment is performed at the supplier's manufacturing facility. Similar to the paper producer's selection of a roll cover supplier, the selection of a refurbishment provider is influenced by the time and expense of transporting a roll cover. Refurbishment services typically cost between \$1,000 for minor roll repairs and \$50,000 for a complete overhaul on certain press rolls.

We offer a wide range of mechanical maintenance and repair services for the internal mechanisms of rolls. Paper producers are increasingly finding it economical to have the company that refurbishes or replaces a roll cover also perform work on the internal roll mechanisms at the same time, which avoids having multiple suppliers and incurring additional time and transportation charges. We have begun performing such services to meet the demands of our customers and attempt to gain a competitive advantage. As of December 31, 2011, we provide major mechanical services at ten locations around the world. Roll cover refurbishment services and mechanical services accounted for approximately 24% of our total net sales in our roll covers segment in 2011.

Spreader rolls. We manufacture and repair spreader rolls, which are small-diameter curved rolls used throughout a paper-making machine to stretch, smooth and remove wrinkles from the paper and clothing. There are approximately five to seven spreader rolls in a typical paper-making machine. We typically sell spreader rolls for between \$1,000 and \$200,000 per roll. We also rebuild and overhaul existing spreader rolls, typically for between \$1,000 and \$100,000 per roll. Net sales of spreader rolls and related services accounted for approximately 21% of our total net sales in our roll covers segment in 2011.

New Roll Products. We have introduced a number of innovations to our roll cover and spreader roll products in recent years, including shoe press belts which utilize our expertise in polyurethane material and manufacturing technologies, composite calendar roll covers that use nanoparticle technology to improve roll cover durability and paper gloss, as well as covers that use an improved polyurethane to increase abrasion and moisture resistance as well as responsiveness and stability. We are evaluating new products, which will use different materials and utilize different sales channels and provide enhancements to our existing product line. In late 2008, we introduced SmartRoll™, the first continuous pressure sensing paper machine roll. SmartRoll™ enables the paper maker to maximize performance by qualitatively measuring the operating pressures of the paper machine while the machine is running. As of December 31, 2011, customers have ordered 200 SmartRoll™ units and approximately 85% of those are already operational, confirming market acceptance.

In 2011, paper producers accounted for approximately 79% of net sales in our roll covers segment, and paper-making machine manufacturers accounted for approximately 7% of net sales. Net sales for use in other industrial applications, including steel, plastics, leather and textiles manufacturing, accounted for the remaining 14% of our net sales in our roll covers segment.

Customers

We supply leading paper producers worldwide. Our top ten customers accounted for 22.3% of net sales in 2011 and individually, no customer accounted for more than 4.0% of 2011 net sales. In 2011, 35.9% of our net sales were generated in North America, 33.6% in Europe, 9.4% in South America, 19.2% in Asia-Pacific and 1.9% in the rest of the world. See Note 15 to the accompanying audited consolidated financial statements for geographic information related to net sales and long-lived assets. Due to competitive market forces, we offer our customers payment terms similar to those offered by our competitors. Also, agreements with certain customers require us to maintain modest amounts of finished clothing inventory to assure those customers of supply continuity. We do not maintain finished rolls inventories.

Competition

Our largest competitors are Albany International Corp. (a publicly-owned U.S. company), which supplies clothing products, Voith AG (a privately-owned German company) and Metso Corporation (a publicly-owned Finnish company), both of which supply both clothing and roll products. Voith and Metso are also the leading manufacturers of paper-making machines. In addition, we also face competition from smaller regional suppliers.

We compete primarily based on the value and price of our products. Competition with respect to both clothing and roll covers, particularly as it relates to our technologically advanced forming fabrics, press felts and roll covers, is based primarily on the value that the products deliver to the paper producer through the ability of such products to reduce production costs and improve paper quality.

Competition in the clothing and roll covers market is also based on a supplier's ability to deliver engineering and technical services. Many paper producers have been reducing their in-house engineering and technical staff and increasingly expect their suppliers to provide such services. While smaller suppliers often lack the resources necessary to invest in and provide this level of engineering and technical service, we have made investments in order to provide the following services to the paper producers: specialist advice and resident engineers, installation support, on-call "trouble-shooting" and performance monitoring and analysis of paper-making machines.

In the roll covers market, competition is also based on a supplier's proximity to the paper producer's facilities, which affects the transportation time and expense associated with refurbishing or replacing a roll cover, and on the supplier's ability to provide mechanical services to a roll's internal mechanisms while the roll cover is being refurbished or replaced. We offer an extensive network of facilities throughout the world and provide mechanical services at ten locations.

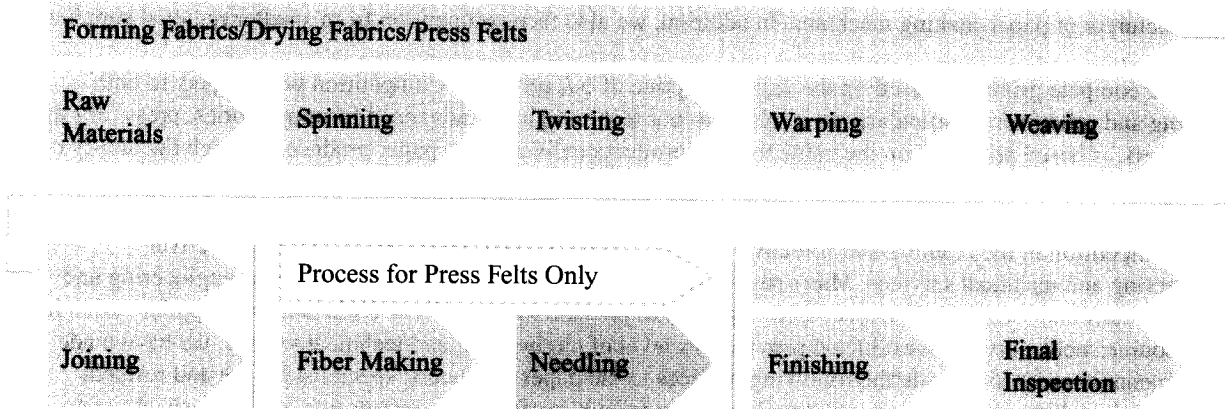
Research and Development

Our continuing ability to deliver value depends on developing product innovations. As we create new and improved products we are often able to obtain patent protection for our innovations, which is indicative of our technical capabilities and creativity. Although we do not consider any single patent to be material to our business, we believe that, in the aggregate, our patents and other intellectual property provide us with a competitive advantage. At December 31, 2011, we have approximately 280 domestic and foreign patents outstanding and approximately 105 pending patent applications. Some of our competitors license our technology from us in exchange for royalty payments, although such licensing does not represent a material amount of our business. Research and development expenses totaled \$12.1 million, \$11.4 million and \$11.3 million in 2011, 2010 and 2009, respectively, and were approximately 2.1% of our net sales in 2011 and 2010 and 2.3% of our net sales in 2009.

Production

Clothing Production Process

The following diagram represents the clothing production process.



The clothing production process begins with the spinning of synthetic fiber threads to produce yarn, which is then twisted in preparation for the manufacturing of clothing. Yarn, which is sometimes purchased as a raw material, is then wound on large spools prior to installation on the loom. The yarn is drawn through needles in preparation for weaving.

With the yarn prepared for weaving, a weave pattern can be installed in the loom controller. The nature of the weave pattern is critical to how the clothing performs in the paper-making process. The yarn is then woven to the desired length.

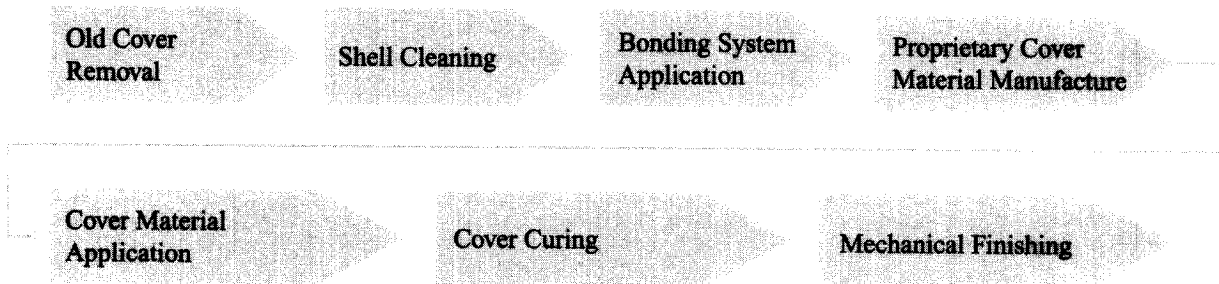
Technological advancements have resulted in weaving becoming an almost entirely automated process. Following weaving, the two ends are permanently joined to form a continuous loop of clothing. Although significant automation has occurred in the joining process, it remains the most labor intensive of the clothing production process.

Press felts then undergo a process that is not necessary for forming and dryer fabrics. An additional layer of fibers is added to the outside surface with the use of an advanced needling machine, such that a very smooth felt surface is created.

All clothing then undergoes heat setting and chemical treating. Heat setting tightens the clothing giving it the necessary mechanical properties for the paper-making process. Finally, the clothing is meticulously inspected prior to being shipped to the customer.

Roll Cover Production Process

The following diagram represents the roll covering production process.



The covering on the rolls used in the paper-making process wear over time and must be periodically replaced for the roll to function properly. Rolls are removed from the paper-making machine and taken to an offsite facility for re-covering. During this time, a spare roll is placed in the machine to enable continuous operations.

The first step of the roll covering process is the removal of the old cover. A lathe and belt grinder are used to remove the old cover, exposing the roll shell. The shell is cleaned with a pressure washer and blasted with solid particles to increase the shell's surface area for bonding of the new cover. Following the blasting process, the shell is ready to be re-covered.

The shell is then coated with proprietary bonding agents that affix the new roll cover to the shell. Each type of cover material is applied with a different process. Rubber and composite covers are extruded in a slow spinning lathe. Polyurethane covers are typically cast on the core using a mold, and ceramic covering is expelled onto the shell at high pressure.

Following application of the core material, the cover undergoes a curing process. Rubber covers are cured for 12 to 28 hours in vulcanizers under high temperature and pressure, whereas polyurethane and composite materials are cured in a hot air oven. After curing, the roll cover is ground with belts and grinding stones. A proprietary pattern of holes and grooves is then drilled into the cover to aid in water removal. Finally, the roll is balanced for proper spinning motion and meticulously checked for quality before being returned to the customer.

The roll cover production process is capital intensive and requires a variety of equipment, including lathes, belt grinders, polyurethane casting molds (for polyurethane roll covers), extruders, mix stations, vulcanizers, ovens and balancing equipment.

Raw Materials

Primary raw materials used in our paper machine clothing production are synthetic yarns and fibers. The primary raw materials used in our roll cover products are natural and synthetic rubber, epoxy resins and polyurethane. A number of suppliers provide the materials used in our product lines, so availability has not posed a significant concern, however, because both the clothing and certain roll cover materials are petroleum-based, their prices are subject to changes in the price of petroleum. Natural rubber prices tend to be influenced directly by the health of the automotive industry and have seen substantial increases as that industry recovers.

Environmental

Our operations and facilities are subject to a number of national, state and local laws and regulations protecting the environment and human health in the United States and foreign countries that govern, among other things, the handling, storage and disposal of hazardous materials, discharges of pollutants into the air and water and workplace safety. Because of our operations, the history of industrial uses at some of our facilities, the operations of predecessor owners or operators of some of the businesses, and the use and release of hazardous substances at these sites, the liability provisions of environmental laws may affect us.

We believe that any liability in excess of amounts provided in Note 12 to the Consolidated Financial Statements which may result from the resolution of such matters will not have a material adverse effect on our financial condition, liquidity or cash flow.

Employees

As of December 31, 2011 we had 3,448 employees worldwide, of which 2,612 were manufacturing employees, 429 were sales and marketing employees, 100 were in research and development and 307 were administrative and other employees. As of December 31, 2011, 2,325 or 68%, of our employees are members of labor unions, trade unions, employee associations or workers councils. We believe that we have good relations with our employees and the various groups that represent our employees.

Our Corporate Information

We are subject to the information requirements of the Securities Exchange Act of 1934 (the “Exchange Act”). Therefore, we file periodic reports, proxy statements, and other information with the SEC. Such reports, proxy statements, and other information may be obtained by visiting the Public Reference Room of the SEC at 100 F Street, NE, Washington, DC 20549 or by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site at <http://www.sec.gov> that contains reports, proxy and information statements, and other information regarding issuers that file electronically.

We maintain a website at www.xerium.com to provide information to the general public and our shareholders on our products and services, along with general information on Xerium. We make our periodic and current reports available, free of charge, on our web site as soon as reasonably practicable after these reports are filed with, or furnished to, the SEC. Our corporate code of business conduct and ethics, our corporate governance guidelines, and the charters of each of the Audit, Compensation, and Nominating and Corporate Governance Committees of our board of directors are also made available, free of charge, on our website. Our corporate code of business conduct and ethics, which includes our code of ethics, and related waivers (if any) are posted on our website and we intend to post on our website and (if required) file on Form 8-K all disclosures required by applicable law or the rules of the SEC concerning any amendment to, or waiver from our code of ethics. Copies of these documents may be obtained, free of charge, by writing Investor Relations, Xerium Technologies, Inc., 8537 Six Forks Road, Suite 300, Raleigh, North Carolina 27615, or telephoning us at 919-526-1444.

ITEM 1A. RISK FACTORS

Our business, results of operations and financial condition, and an investment in our securities, are subject to various risks. Investors should carefully consider the risks described below in conjunction with the other information in this Form 10-K, including our consolidated financial statements and related notes. If any of the following risks or other risks which have not been identified or which we may believe are immaterial or unlikely, actually occur, our business, financial condition and results of operations could be harmed. This could cause the value of our securities to decline and holders could lose part or all of their investment. This section does not describe all risks applicable to us, our business or industry, and it is intended only as a summary of certain material factors.

Risks Relating to Our Business and the Industry

Our operations and our industry may be adversely affected by the European debt crisis.

During 2011, the long term structural deficits in numerous European nations coupled with the deterioration of the economic outlook led weaker European Union nations to a liquidity and solvency crisis. Eurozone leaders have made numerous attempts to solve this debt crisis; but, to date a sustainable long term solution has not been implemented and much uncertainty remains. The crisis has had a negative impact on major European banks. On January 13, 2012, nine European nations had their credit ratings downgraded by Standard and Poor’s by at least one notch. Failure to successfully resolve the debt crisis could lead to significant losses for sovereign debt holders including major European banks and investors. In the worst case, the crisis could lead to the voluntary exit or expulsion of certain countries from the Euro currency block and/or a collapse of the Eurozone financial system. A break up of the Eurozone would be a deeply disruptive global economic event. The ongoing crisis continues to have a negative impact on the European economy. A prolonged downturn could disrupt the current US recovery and weaken global trade, hamper key emerging markets such as China and India, and result in another global recession with reduced demand and lower prices for paper.

Among the various impacts a worsening Eurozone debt crisis could have, the following represent the most material to our operations and industry:

- regional economic recession which could spread globally, significantly impacting the demand for paper and, consequently, our products;

- severe tightening or shut down of credit markets resulting in a deterioration of our customers' credit quality or access to cash lowering the realization rate on our accounts receivable; and
- substantial depreciation of the Euro against our reporting currency, the US Dollar, resulting in increased currency translation risk.

The economic developments mentioned above could have a significant negative impact on our earnings, cash flows, access to capital, liquidity and financial position.

A sustained downturn in the paper industry, compounded by uncertainty in global economic conditions, could adversely affect our net sales and profitability.

Historically, demand for our products has been driven primarily by the volume of paper produced on a worldwide basis. As a result, trends that affect the production level of the paper industry, such as declining demand for newsprint due to increased adoption of digital media, will impact our business and financial results.

The profitability of paper producers has historically been highly cyclical due to wide swings in the price of paper, driven to a high degree by the oversupply of paper during periods when paper producers have more aggregate capacity than the market requires. A sustained downturn in the paper industry, either globally or in a particular region, can cause our paper manufacturing customers to reduce production, cease operations or declare bankruptcy, each of which would adversely affect our net sales and profitability.

In response to significant changes in the sector, particularly in late 2008 and 2009, paper producers have continually sought to structurally improve the balance between the supply of and demand for paper. As part of these efforts, they have permanently shut down many paper-making machines or entire manufacturing facilities. Should papermakers continue to experience low levels of profitability, we would expect that further consolidation among papermakers, reducing the number of paper producers, and shutdowns of paper-making machines or facilities could occur in Europe and North America, until there is a better balance between supply and demand for paper and the profit levels of paper producers improve. This rebalancing was accelerated during the most recent global economic recession.

Global paper production growth that does occur could be moderated by the level of industry consolidation and paper-machine shutdown activity that appears to be an underlying trend in North America and Europe. In 2010, we believed that paper production in both North America and Europe appeared to have bottomed out as market-related curtailment abated. During the first half of 2011, global paper demand increased and machine operating rates escalated across most paper grades and geographic regions, although this expansion slowed substantially during the second half of 2011. We continue to see the trend that paper producers are focusing on cost reduction strategies and, as a result, are extending the life of roll covers and clothing products through additional maintenance cycles before replacing them. We anticipate that pricing pressure for our products may continue with the consolidation among paper producers and as the shift of paper production growth in Asia-Pacific develops.

We may be required to restructure our operations in response to changing conditions in the paper industry, which may require significant expenditures and may not be successful.

In the past several years, we have undertaken various operational restructuring measures in response to changing market conditions in the paper industry triggered by the decline in paper prices that began in 2001. For example, between 2002 and 2011, we incurred costs of approximately \$88 million in connection with our cost reduction programs including the closure of 14 manufacturing facilities worldwide.

In connection with any future plant closures, delays or failures in the transition of production from a closed facility to our other facilities could also adversely affect our financial performance. We may engage in additional cost reduction programs in the future. We may not recoup the costs of programs we have already initiated, or

other programs we may in the future decide to engage in, the costs of which may be significant. In addition, our profitability may decline if our restructuring efforts do not sufficiently reduce our future costs while at the same time positioning us to maintain or increase our sales.

Our manufacturing facilities may be required to increase or decrease production capacity, which could negatively affect our production, customer order time, product quality, labor relations or gross margin.

As part of our efforts to reduce our costs, we have attempted to reduce or eliminate excess manufacturing capacity through closure of certain of our manufacturing plants and consolidation of our production. As a result, however, from time to time our ability to meet customer demand for our products may rely on our ability to operate our remaining manufacturing facilities at or near capacity on an uninterrupted basis. Our manufacturing facilities are dependent on critical equipment, and operating such equipment at or near capacity for extended periods may result in increased equipment failures or other reliability problems, which may result in production shutdowns or periods of reduced production. Such disruptions could have an adverse effect on our operations and financial results. In addition, insufficient manufacturing capacity or other delays may cause our customer order times to increase and our product quality to decrease, which may increase warranty costs and negatively affect customer demand for our products and customer relations generally. Operating our facilities at or near capacity may also negatively affect relations with our employees, which could result in higher employee turnover, labor disputes and disruptions in our operations. On the other hand, if we anticipate or experience a significant decrease in demand for our products, we may choose to temporarily decrease production or idle manufacturing facilities and employees. While decreasing production may mitigate some of the risks of operating at or near capacity discussed above, a significant drop off in production to meet lower demand, including idling facilities or employees, will negatively impact our gross margin.

Fluctuations in currency exchange rates could adversely affect our net sales, profitability and compliance with our debt covenants.

Our foreign operations expose us to fluctuations in currency exchange rates and currency devaluations. We report our financial results in U.S. Dollars, but a substantial portion of our sales, expenses and debt are denominated in Euros and other currencies. As a result, changes in the relative values of U.S. Dollars, Euros and other currencies will affect our levels of net sales and profitability. Currency fluctuations, as they pertain to the Euro, generally have a greater effect on the level of our net sales due to the amount of business we conduct in Euros. An increase in the U.S. Dollar against the Euro generally results in a decrease to net sales and net income. Increases in the U.S. Dollar against other currencies, such as the Brazilian Real, would not impact consolidated net sales as much, as a significant portion of sales in that country is significantly denominated in or indexed to U.S. Dollars, but generally would increase net income as local currency costs would be translated into lower U.S. Dollar expenses for financial reporting purposes. We would expect a similar but opposite effect in a period in which the value of the U.S. Dollar decreases against these currencies. Although in certain circumstances we attempt to hedge our exposure to fluctuations in currency exchange rates, our hedging strategies may not be effective.

In addition, our Credit Facility (defined in “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Credit Facility and Notes.”) contains financial covenants that require us to maintain a minimum interest coverage ratio, a maximum leverage ratio and an annual limitation on capital expenditures. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Credit Facility and Notes”. Our ability to comply with these covenants will depend in part upon our reported financial results, which as indicated above, are directly affected by currency fluctuations. Since each of the financial ratio covenants are calculated by reference to the amount of our Adjusted EBITDA, currency fluctuations alone could lower the amount of our Adjusted EBITDA and therefore affect our ability to remain in compliance with our financial ratio covenants. For the purposes of computing debt, which is a key component in the calculation of the leverage ratio, indebtedness which is payable in foreign currencies shall be converted into U.S. Dollars using the average exchange rate for the most recently ended four fiscal quarters for which our financial statements are available. For additional information about the risks associated with fluctuations in currency exchange rates, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Foreign Exchange”.

Price competition in our industry could adversely affect our gross margins and net sales.

Historically, we and our competitors have been able to sell clothing and roll cover products and services at favorable prices that reflect the value they deliver to customers. This favorable pricing has been particularly derived from our more technologically advanced products, such as forming fabrics, press felts and advanced roll covers. In recent years, due to global economic conditions and over capacity in the paper manufacturing industry, the financial health of our customers and continued pricing pressure from our competitors has required us to price our products, in some cases, at levels insufficient to realize our historical gross margins when faced with increasing raw material and labor costs. Increased pricing pressure from our competitors may require price decreases or make us unable to affect planned price increases and, thereby, adversely affect our profitability.

Our industry is competitive and our future success will depend on our ability to effectively develop, market and supply competitive products.

The paper-making consumables industry is highly competitive. Some of our competitors are larger than us, have greater financial and other resources and are well-established as suppliers to the markets we serve. For example, while we are targeting expansion of our business in China, we face substantial competition from manufacturers already operating there that are more established and familiar with the Chinese marketplace. In addition, some of our competitors also manufacture paper-making machines and have the ability to initially package sales of their clothing and roll cover products with the sale of their machines and/or to tie the warranties on their machines to the use of their clothing and roll cover products. Due to various factors such as price or product innovation by our competitors, our products may not be able to compete successfully with the products of our competitors, which could result in a loss of customers and, as a result, decreased net sales and profitability.

Because we have substantial operations outside the United States, we are subject to the economic and political conditions of foreign nations.

We have manufacturing facilities in 14 foreign countries. In 2011, we sold products in approximately 58 countries other than the United States, which represented approximately 73.3% of our net sales. We operate in a number of foreign countries and may face challenges unique to those countries such as in hiring employees, our relations with various parties, including suppliers and governmental agencies, and in production.

Furthermore, we may decide to do business in countries where we have not previously done business. In such countries we face the additional uncertainty of entering a new market and its social customs, laws and practices. Should these challenges be realized, our operating results could be adversely impacted and our business or production may be delayed.

Our foreign operations are subject to a number of risks and uncertainties, including risks that:

- foreign governments may impose limitations on our ability to repatriate funds;
- foreign governments may impose withholding or other taxes on remittances and other payments to us, or the amount of any such taxes may increase;
- an outbreak or escalation of any insurrection or armed conflict may occur;
- foreign governments may impose or increase investment barriers or other restrictions affecting our business; or
- changes in and interpretations of tax policies of foreign governments may adversely affect our foreign subsidiaries.

The occurrence of any of these conditions could disrupt our business in particular countries or regions of the world, or prevent us from conducting business in particular countries or regions, which could adversely affect our net sales and profitability. In addition, as a holding company we rely on dividends and other payments or distributions from our subsidiaries to meet our debt obligations. If foreign governments impose limitations on our

ability to repatriate funds or impose or increase taxes on remittances or other payments to us, the amount of dividends and other distributions we receive from our subsidiaries could be reduced, which could reduce the amount of cash available to us to meet our debt obligations.

Energy price increases may negatively impact our results of operations.

Certain of the components that we use in our manufacturing activities are petroleum-based. In addition, we, along with our suppliers and customers, rely on various energy sources (including oil) in our transportation activities. While significant uncertainty currently exists about the future levels of energy prices, a significant further increase is possible. Increased energy prices could cause an increase to our raw material costs and transportation costs. In addition, increased transportation costs of certain of our suppliers could be passed along to us. We may not be able to increase our prices enough to offset these increased costs. In addition, any increase in our prices may reduce our future customer orders and profitability.

We must continue to innovate and improve our products to maintain our competitive advantage.

We compete primarily based on the value our products deliver to our customers. Our value proposition is based on a combination of price and the technology and performance of our products, including the ability of our products to help reduce our customers' production costs and increase the quality of the paper they produce. Our ability to retain our customers and increase our business depends on our ability to continually develop new, technologically superior products that support our value proposition. We cannot assure that our investments in technological development will be sufficient, that we will be able to create and market new products, that such new products will be accepted by our customers or that we will be successful in competing against new technologies developed by competitors. In addition, either we or our competitors could develop new technologies that increase the useful life of clothing or roll covers, which could reduce the frequency with which our customers would need to replace their clothing and refurbish or replace their roll covers, and consequently lead to fewer sales.

We believe that market recognition of the extended life of our roll cover products and the trend towards new paper-making machine designs which have fewer rolls will continue to negatively impact the demand for our roll cover products.

We have seen a trend that paper producers are placing an increasingly strong emphasis on maintenance cost reduction and, as a result, are extending the life of roll covers through additional maintenance cycles before replacing them. Market recognition of the extended life of our roll cover products negatively impacts the demand for these products. In addition, we have seen a trend towards new paper-making machine designs which have fewer rolls, also negatively impacting the demand for our roll cover products. If we are not able to offset these negative impacts on the demand for our roll cover products with growth from new roll cover products, the sale of roll cover products in regions which we believe have high growth potential such as China, or from other sources, the volume of our roll cover sales will be adversely affected.

The loss of our major customers could have a material adverse effect on our net sales and profitability.

Our top ten customers generated 22.3% of our net sales during 2011. The loss of one or more of our major customers, financial difficulties faced by our customers or a substantial decrease in such customers' purchases from us, could have a material adverse effect on our net sales and profitability. Because we do not generally have binding long-term purchasing agreements with our customers, there can be no assurance that our existing customers will continue to purchase products from us.

We may fail to adequately protect our proprietary technology, which would allow competitors or others to take advantage of our research and development efforts.

We rely upon trade secrets, proprietary know-how, and continuing technological innovation to develop new products and remain competitive. If our competitors learn of our proprietary technology, they may use this information to produce products that are equivalent or superior to our products, which could reduce the net sales of our products. Our employees, consultants, and corporate collaborators may breach their obligations not to reveal our confidential information, and any remedies available to us may be insufficient to compensate our damages. Even in the absence of such breaches, our trade secrets and proprietary know-how may otherwise become known to our competitors, or be independently discovered by our competitors, which could adversely affect our competitive position.

Our success and ability to compete in the future may depend upon obtaining sufficient patent protection for proprietary technology.

Our patent applications may not result in issued patents, and even if they result in issued patents, the patents may not have claims of the scope we seek. Even in the event that these patents are not issued, the applications may become publicly available and proprietary information disclosed in the applications will become available to others. In addition, any issued patents may be challenged, invalidated or declared unenforceable. The term of any issued patent in the United States is 20 years from its filing date, and if our applications are pending for a long time period, we may have a correspondingly shorter term for any patent that may be issued. Our present and future patents may provide only limited protection for our technology and may not be sufficient to provide competitive advantages to us. For example, competitors could be successful in challenging any issued patents or, alternatively, could develop similar or more advantageous technologies on their own or design around our patents. Also, patent protection in certain foreign countries may not be available or may be limited in scope and any patents obtained may not be as readily enforceable as in the United States, making it difficult for us to effectively protect our intellectual property from misuse or infringement by other companies in these countries. Our inability to obtain and enforce our intellectual property rights in some countries may harm our business. In addition, given the costs of obtaining patent protection, we may choose not to protect certain innovations that later turn out to be important.

We may be liable for product defects or other claims relating to our products.

Our products could be defective, fail to perform as designed or otherwise cause harm to our customers, their equipment or their products. If any of our products are defective, we may be required to recall the products and/or repair or replace them, which could result in substantial expenses and affect our profitability. Any problems with the performance of our products could harm our reputation, which could result in a loss of sales to customers and/or potential customers. In addition, if our customers believe that they have suffered harm caused by our products, they could bring claims against us that could result in significant liability. A failure of our products could cause substantial damage to a paper-making machine. Any claims brought against us by customers may result in:

- diversion of management's time and attention;
- expenditure of large amounts of cash on legal fees, expenses, and payment of damages;
- decreased demand for our products and services; and
- injury to our reputation.

Our insurance may not sufficiently cover a large judgment against us or a large settlement payment, and is subject to customary deductibles, limits and exclusions.

We may be adversely affected if we fail to attract and retain key personnel.

Our future success depends on the continued contributions of our key senior management personnel, however, we anticipate that Stephen R. Light, our current Chairman, President and Chief Executive Officer, will retire during 2012. While we are searching for a permanent replacement, we can give no assurances as to when, or if, we will locate a suitable candidate, and we may be adversely affected if we are unable to identify a qualified permanent replacement for Mr. Light in a timely manner. Besides the anticipated loss of Mr. Light, the loss of services of any of our other key personnel might significantly delay or prevent the achievement of our business objectives and could cause us to incur additional costs to recruit replacements. Each member of our executive management team may terminate his or her employment at any time. We do not maintain “key person” life insurance with respect to any of our executives.

We could incur substantial costs as a result of violations of or liabilities under laws protecting the environment and human health.

Our operations and facilities are subject to a number of national, state and local laws and regulations protecting the environment and human health in the United States and foreign countries that govern, among other things, the handling, storage and disposal of hazardous materials, discharges of pollutants into the air and water and workplace safety. The U.S. Federal Comprehensive Environmental Response, Compensation and Liability Act, as amended (“CERCLA”) provides for responses to, and, in some instances, joint and several liability for releases of hazardous substances into the environment. Environmental laws also hold current owners or operators of land or businesses liable for their own and for previous owners’ or operators’ releases of hazardous or toxic substances, materials or wastes, pollutants or contaminants, including petroleum and petroleum products. Because of our operations, the history of industrial uses at some of our facilities, the operations of predecessor owners or operators of some of the businesses, and the use and release of hazardous substances at these sites, the liability provisions of environmental laws may affect us. Many of our facilities have experienced some level of regulatory scrutiny in the past and are or may be subject to further regulatory inspections, future requests for investigation or liability for regulated materials management practices.

We cannot assure that we have been or will be at all times in complete compliance with all laws and regulations applicable to us which are designed to protect the environment and human health. We could incur substantial costs, including clean-up costs, fines and sanctions and third party property damage or personal injury claims, as a result of violations of or liabilities under environmental laws, relevant common law or the environmental permits required for our operations or under workplace safety laws. While we believe that the current level of reserves is adequate, the adequacy of these reserves may change in the future due to new developments in particular matters.

Adverse labor relations could harm our operations and reduce our profitability.

As of December 31, 2011, we had 3,448 employees worldwide, approximately 14% of whom were subject to protection of various North American collective bargaining agreements and approximately 53% of whom were subject to job protection as members of European or South American trade unions, employee associations or workers’ councils. As of December 31, 2011, approximately 9% of the employees subject to North American collective bargaining agreements (or approximately 1% of our total employees) were covered by an agreement that was set to expire prior to December 31, 2012. We cannot be certain that we will be able to renew the collective bargaining agreement set to expire this year, or enter into a new collective bargaining agreement that does not adversely affect our operating result, or that we will be without production interruptions, including labor stoppages. In addition, all of our European and South American employees subject to job protection as members of trade unions, employee associations or workers’ councils are subject to arrangements that typically result in higher negotiated or mandated salary increases on either an annual or biannual basis. We cannot be certain that the terms of employment applicable to such employees will not change in the future in a manner which adversely affects our operating results. We cannot be certain that we will not experience disruptions in our operations as a

result of labor disputes or experience other labor relations issues. If we are unable to maintain good relations with our employees, our ability to produce our products and provide services to our customers could be reduced and/or our production costs could increase, either of which could disrupt our business and reduce our net sales and profitability.

We may be subject to assessment of income taxes for which we have not accrued any liability.

We accrue for certain known and reasonably anticipated income tax obligations after assessing the likely outcome. In the event that actual results differ from these accruals or if we become subject to a tax obligation for which we have made no accrual, we may need to make adjustments, which could materially impact our financial condition and results of operations. For example, taxing authorities may disagree with our tax accounting methodologies and may subject us to inquiries regarding such taxes, which potentially could result in additional income tax assessments against us. In accordance with accounting rules, we do not accrue for potential income tax obligations if we deem a particular tax position, based solely on its technical merits, is more likely than not to be sustained upon examination. In making our determination, we assume that the taxing authorities will have access to all relevant facts and information.

In November 2011, Xerium Technologies Brasil Indústria e Comércio S.A., a Brazilian indirect subsidiary, received a notice of proposed income tax assessment from the Federal Revenue Department of the Ministry of Finance of Brazil totaling approximately \$42.6 million (subject to currency exchange rates). Although there can be no assurances, we believe at this time, that it is more likely than not that we will prevail on every tax position under examination and therefore have not accrued any amounts related to this assessment. Because we are at a preliminary stage of the process for resolving this dispute with the Federal Revenue Department, we cannot assure a favorable outcome and cannot currently estimate the timing of the final resolution of this matter. We believe we have meritorious defenses and will vigorously contest this matter. However, if the Federal Revenue Department's initial position is sustained, the amount assessed would result in a material adjustment to our consolidated financial statements and would adversely impact our financial condition and results of operations.

Risks Relating to Our Capital Structure

Our level of indebtedness could adversely affect our ability to raise additional capital to fund our operations, limit our ability to plan for and react to changes in the economy, our industry or our business and prevent us from meeting our debt obligations.

We are significantly leveraged. As of December 31, 2011, our total indebtedness was approximately \$469.1 million. Our substantial degree of leverage could have important consequences to us, including the following:

- it may limit our ability to obtain additional debt or equity financing for working capital, capital expenditures, product development, debt service requirements, acquisitions or general corporate or other purposes;
- a substantial portion of our cash flows from operations will be dedicated to the payment of principal and interest on our indebtedness and will not be available for other purposes, including our operations, capital expenditures, and other business opportunities;
- certain of our borrowings, including borrowings under our Credit Facility, are at variable rates of interest, exposing us to the risk of increased interest rates;
- if we seek to refinance our debt or require additional refinancing in the future, we may be unable to do so on attractive terms or at all;
- it may limit our flexibility in planning for, or our ability to adjust to, changes in our business or the industry in which we operate, and place us at a competitive disadvantage compared to our competitors that have less debt; and
- we may be vulnerable to a downturn in general economic conditions or in our business, or we may be unable to carry out capital spending that is important to our growth.

We may not be able to generate sufficient cash to service all of our indebtedness and be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful.

Our ability to make scheduled payments or to refinance our debt obligations depends on our financial and operating performance, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. There can be no assurance that our future operating performance will generate sufficient cash flows to support our cash requirements. If our cash flows and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay capital expenditures, sell assets or operations, seek additional capital or restructure or refinance our indebtedness. There can be no assurance that we would be able to take any of these actions, that these actions would be successful and permit us to meet our scheduled debt service obligations or that these actions would be permitted under the terms of our existing or future debt agreements, including the Credit Facility or the indenture that governs our 8.875% senior unsecured notes due 2018 (“Notes”). In the absence of such operating results and resources, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations. Our Credit Facility and the indenture that governs the Notes restrict our ability to dispose of assets and use the proceeds from the disposition. We may not be able to consummate those dispositions or to obtain the proceeds which we could realize from them and these proceeds may not be adequate to meet any debt service obligations then due.

If we cannot make scheduled payments on our debt, we will be in default and, as a result:

- our debt holders could declare all outstanding debt to be due and payable;
- the lenders under our Credit Facility could terminate their commitments to lend us money, declare all outstanding amounts there under due and payable, and foreclose against the assets securing their borrowings; and
- we could be forced into bankruptcy or liquidation, which could result in our security holders’ loss of their investment.

Despite current indebtedness levels, we may still be able to incur substantially more debt. This could further exacerbate the risks described above.

We and our subsidiaries may be able to incur substantial additional indebtedness in the future. The terms of the indenture governing the Notes do not fully prohibit us or our subsidiaries from doing so. If we incur any additional indebtedness that ranks *pari passu* with the Notes, the holders of that new debt will be entitled to share ratably with the Note holders in any proceeds distributed in connection with any insolvency, liquidation, reorganization, dissolution or other winding-up of us. This may have the effect of reducing the amount of proceeds paid to our Note holders. Additionally, our Credit Facility includes up to a \$30.0 million committed revolving credit facility, under which we may borrow from time to time. Furthermore, we have an uncommitted incremental credit facility allowing for increases under the revolving credit facility and term loans, and borrowing of new tranches of term loans, in each case, up to an aggregate principal amount not to exceed the greater of (i) \$100.0 million and (ii) our and our subsidiaries’ Adjusted EBITDA (as defined in the agreement governing our Credit Facility) for the most recent four fiscal quarters. If new debt is added to our current debt levels, the related risks that we and our subsidiaries now face could intensify. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Credit Facility and Notes” for a more complete description of the terms and features of the Credit Facility and the Notes.

Our Credit Facility and the indenture governing our Notes include a number of significant restrictions and covenants that limit our flexibility in operating our business.

Our Credit Facility and the indenture governing our Notes include a number of customary and significant restrictions and covenants, subject to certain exceptions, that limit our ability to, among other things:

- incur or guarantee additional indebtedness;
- pay dividends or distributions on capital stock or redeem or repurchase capital stock;

- make investments;
- create restrictions on the payment of dividends or other amounts to us;
- sell stock of our subsidiaries;
- transfer or sell assets;
- create liens;
- enter into certain transactions with affiliates; and
- enter into mergers or consolidations.

In addition, the restrictive covenants in our Credit Facility require us to maintain specified financial ratios and satisfy other financial condition tests. Our ability to meet those financial ratios and tests can be affected by events beyond our control, and we can give no assurance that we will meet them. A breach of any of these covenants could result in a default under our Credit Facility. Upon the occurrence of an event of default under our Credit Facility, the lenders could elect to declare all amounts outstanding there under to be immediately due and payable and terminate all commitments to extend further credit. If we were unable to repay those amounts, the lenders under our Credit Facility could proceed against the collateral granted to them to secure that indebtedness. We have pledged a significant portion of our assets as collateral under our Credit Facility. If the lenders under our Credit Facility accelerate the repayment of borrowings, there can be no assurance that we will have sufficient assets to repay our Credit Facility and our other indebtedness, including the Notes, or borrow sufficient funds to refinance such indebtedness. Even if we are able to obtain new financing, it may not be on commercially reasonable terms, or terms that are acceptable to us.

Fluctuations in interest rates could adversely affect our liquidity, interest expense and financial results.

The term loans under our Credit Facility have variable interest rates. To the extent that we do not enter into hedging arrangements that effectively fix the interest rate on a portion of our senior debt, the interest rate on all of the debt covered by our Credit Facility will fluctuate based on LIBOR, Euribor and other variable interest rates. To the extent these interest rates increase, our interest expense may increase, in which event, we may have difficulty making interest payments and funding our other costs and our ability to comply with the financial covenants in our Credit Facility may be adversely affected. On August 8, 2011, we entered into interest rate caps covering a portion of our floating rate debt, which provide interest rate protection in the event LIBOR or Euribor exceed 3.0%. Consequently, our financial statements are exposed to the effects of interest rate fluctuations below 3.0%, which could have a material impact on our results of operations.

Risks Relating to Our Notes

Not all of our subsidiaries guarantee our obligations under the Notes, and the Notes are structurally subordinated to all indebtedness of our non-guarantor subsidiaries.

The Notes are guaranteed by each of our existing and subsequently acquired, direct or indirect wholly-owned domestic subsidiaries. Except for such subsidiary guarantors of the Notes, our subsidiaries, including all of our foreign subsidiaries and our subsidiaries that are less than wholly-owned, have no obligation, contingent or otherwise, to pay amounts due under the Notes or to make any funds available to pay those amounts, whether by dividend, distribution, loan or other payment.

The Notes are structurally subordinated to all indebtedness and other obligations of any non-guarantor subsidiary, even if such obligations do not constitute senior indebtedness, such that, in the event of insolvency, liquidation, reorganization, dissolution or other winding up of any non-guarantor subsidiary, all of such subsidiary's creditors (including trade creditors and preferred stockholders, if any) would be entitled to payment in full out of such subsidiary's assets before we would be entitled to any payment. As a result, the Notes are effectively subordinated to all liabilities of our non-guarantor subsidiaries.

Our non-guarantor subsidiaries also may be subject to restrictions on their ability to distribute cash to us as a result of law and, as a result, we may not be able to access their cash flows to service our debt obligations, including the Notes.

Our non-guarantor subsidiaries accounted for approximately \$455.3 million or 77.6% of our net sales for the twelve month period ended December 31, 2011 and \$496.0 million or 74.5% of our total assets and \$378.8 million or 56.7% of our total liabilities as of December 31, 2011.

A Note holder's right to receive payments on the Notes is effectively junior to those lenders who have a security interest in our assets.

Our obligations under the Notes and the guarantors' obligations under their guarantees of the Notes are unsecured. As a result, the Notes and the related guarantees are effectively subordinated to all of our and the guarantors' secured indebtedness to the extent of the value of the assets securing such indebtedness. Our obligations under our Credit Facility are secured by a pledge of substantially all of our and our guarantors' tangible and intangible assets. In the event that we or a guarantor are declared bankrupt, become insolvent or are liquidated or reorganized, our obligations under our Credit Facility and any other secured obligations will be entitled to be paid in full from our assets or the assets of such guarantor, as the case may be, pledged as security for such obligation before any payment may be made with respect to the Notes. Holders of the Notes would participate ratably in our remaining assets or the remaining assets of the guarantor, as the case may be, with all holders of unsecured indebtedness that are deemed to rank equally with the Notes, based upon the respective amount owed to each creditor. In addition, if we default under our Credit Facility, the lenders could declare all of the funds borrowed there under, together with accrued interest, immediately due and payable. If we were unable to repay such indebtedness, the lenders could foreclose on the pledged assets to the exclusion of holders of the Notes, even if an event of default exists under the indenture under which the Notes were issued at such time. Furthermore, if the lenders foreclose and sell the pledged equity interests in any subsidiary guarantor under the Notes, then that subsidiary guarantor will be released from its guarantee of the Notes automatically and immediately upon such sale. In any such event, because the Notes are not secured by any of our assets or the equity interests in subsidiary guarantors, it is possible that there would be no assets remaining from which Note holder claims could be satisfied or, if any assets remained, they might be insufficient to satisfy Note holder claims fully.

As of December 31, 2011, we and our guarantor subsidiaries had \$227.1 million of secured indebtedness under our Credit Facility which does not include additional borrowing availability under our revolving credit facility or incremental facility. The indenture governing the Notes permits the incurrence of substantial additional indebtedness by us and our restricted subsidiaries in the future, including secured indebtedness. Any secured indebtedness incurred would rank senior to the Notes to the extent of the value of the assets securing such indebtedness.

Our ability to repay the Notes depends on the performance of our subsidiaries, including our non-guarantor subsidiaries, and their ability to make payments or distributions.

We conduct a significant portion of our operations through our subsidiaries. Accordingly, repayment of our indebtedness, including the Notes, is dependent, to a significant extent, on the generation of cash flow by our subsidiaries and their ability to make such cash available to us, by dividend, debt repayment or otherwise. Unless they are guarantors of the Notes, our subsidiaries, including all of our foreign subsidiaries, do not have any obligation to pay amounts due on the Notes or to make funds available for that purpose. Our subsidiaries may not be able to, or may not be permitted to, make distributions to enable us to make payments in respect of our indebtedness, including the Notes. Each subsidiary is a distinct legal entity and, under certain circumstances, legal and contractual restrictions may limit our ability to obtain cash from our subsidiaries. While the indenture governing the Notes limits the ability of certain of our subsidiaries to incur consensual restrictions on their ability to pay dividends or make other intercompany payments to us, these limitations are subject to certain qualifications and exceptions.

If cash flow from our U.S. operations is insufficient to make payments of principal and interest on our debt, including amounts due under the Notes, we must rely on cash flow from our foreign operations to make these payments.

In addition, our ability to repatriate cash generated by our foreign operations or borrow from our foreign subsidiaries may be limited by tax, foreign exchange or other laws. Foreign earnings may be subject to withholding requirements for foreign taxes. Cash we hold in foreign entities may become subject to exchange controls that prevent their being converted into other currencies, including dollars. Foreign tax laws may affect our ability to repatriate cash from foreign subsidiaries in a tax efficient manner or at all. Legal and contractual dividend restrictions may prevent foreign subsidiaries from paying dividends or other cash distributions to service payments on the Notes, and directors and officers of such foreign subsidiaries may therefore be unable or unwilling to authorize such payments or such loans. If these or other risks limit our ability to transfer cash generated by our foreign operations to us, our ability to make payments on our debt, including amounts due under the Notes, would be harmed.

We may not be able to satisfy our obligations to holders of the Notes upon a change in control.

In the event of a change in control, each Note holder may require us to purchase all or a portion of his or her Notes at a price equal to 101% of the principal amount thereof, plus accrued and unpaid interest thereon to the date of purchase. Our ability to repurchase the Notes upon a change in control is limited by the terms of our Credit Facility and our other debt. Upon a change in control, we may be required immediately to repay the outstanding principal, any accrued interest and any other amounts owed by us under the Credit Facility. There can be no assurance that we would be able to repay amounts outstanding under the Credit Facility or obtain necessary consents under the Credit Facility to repurchase the Notes. Any requirement to offer to purchase any outstanding Notes may result in us having to refinance our other outstanding debt, which we may not be able to do. In addition, even if we were able to refinance this debt, the refinancing may not be on terms favorable to us. Our failure to purchase the Notes would be a default under the indenture governing the Notes.

The change in control provision in the indenture may not protect Note holders in the event we consummate a highly leveraged transaction, reorganization, restructuring, merger or other similar transaction, unless such transaction constitutes a change in control under the indenture. Such a transaction may not involve a change in voting power or beneficial ownership or, even if it does, may not involve a change of the magnitude required under the definition of change in control triggering event in the indenture to trigger our obligation to repurchase the Notes. Except as described above, the indenture does not contain provisions that permit the holders of the Notes to require us to repurchase or redeem the Notes in an event of a takeover, recapitalization or similar transaction.

Federal and state fraudulent transfer laws may permit a court to void the Note guarantees, and, if that occurs, Note holders may not receive any payments on the Notes.

Federal and state fraudulent transfer and conveyance statutes may apply to the issuance of the Notes and the incurrence of the guarantees. Under federal bankruptcy law and comparable provisions of state fraudulent transfer or conveyance laws, which may vary from state to state, the Notes or guarantees could be voided as a fraudulent transfer or conveyance if (i) we or any of the guarantors, as applicable, issued the Notes or incurred the guarantees with the intent of hindering, delaying or defrauding creditors or (ii) we or any of the guarantors, as applicable, received less than reasonably equivalent value or fair consideration in return for either issuing the Notes or incurring the guarantees, and, in the case of (ii) only, one of the following is also true at the time thereof:

- we or any of the guarantors, as applicable, were insolvent or rendered insolvent by reason of the issuance of the Notes or the incurrence of the guarantees;
- the issuance of the Notes or the incurrence of the guarantees left us or any of the guarantors, as applicable, with an unreasonably small amount of capital to carry on the business;

- we or any of the guarantors intended to, or believed that we or such guarantor would, incur debts beyond our or such guarantor's ability to pay as they mature; or
- we or any of the guarantors was a defendant in an action for money damages, or had a judgment for money damages docketed against us or such guarantor if, in either case, after final judgment, the judgment is unsatisfied.

A court would likely find that we or a guarantor did not receive reasonably equivalent value or fair consideration for the Notes or such guarantee if we or such guarantor did not substantially benefit directly or indirectly from the issuance of the Notes or the applicable guarantee. As a general matter, value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied.

We cannot be certain as to the standards a court would use to determine whether or not we or the guarantors were solvent at the relevant time or, regardless of the standard that a court uses, that the issuance of the guarantees would not be further subordinated to our or any of our guarantors' other debt. Generally, however, an entity would be considered insolvent if, at the time it incurred indebtedness:

- the sum of its debts, including contingent liabilities, was greater than the fair saleable value of all its assets;
- the present fair saleable value of its assets was less than the amount that would be required to pay its probable liability on its existing debts, including contingent liabilities, as they become absolute and mature; or
- it could not pay its debts as they become due.

Each guarantee of the Notes contains a provision designed to limit the subsidiary guarantor's liability to the maximum amount that it could incur without causing the incurrence of obligations under its guarantee to be a fraudulent transfer. However, there is some doubt as to whether this provision is effective to protect such guarantee from being voided under fraudulent transfer law. In a recent Florida bankruptcy case, a similar provision was found to be ineffective to protect the guarantees.

If a court were to find that the issuance of the Notes or the incurrence of the guarantee was a fraudulent transfer or conveyance, the court could void the payment obligations under the Notes or such guarantee or further subordinate the Notes or such guarantee to presently existing and future indebtedness of ours or of the applicable guarantor, or require the holders of the Notes to repay any amounts received with respect to such guarantee. In the event of a finding that a fraudulent transfer or conveyance occurred, Note holders may not receive any repayment on the Notes. Further, the voidance of the Notes could result in an event of default with respect to our and our subsidiaries' other debt that could result in acceleration of such debt.

Our Notes are not listed on an exchange and the market price for our Notes may be volatile.

Our Notes are not listed on an exchange and we do not know if or when an active trading market for our Notes will develop, if at all. In addition, the market for non-investment-grade debt has been subject to disruptions that have caused substantial volatility in the prices of securities similar to our Notes. The market for our Notes, if any, may be subject to similar disruptions, and any such disruptions may adversely affect their value. Holders may not be able to sell their Notes at a particular time or at a favorable price.

Risks Relating to Our Common Stock

We do not anticipate paying a dividend on our common stock in the foreseeable future, which may adversely affect the market price of our common stock.

Our Credit Facility and the indenture governing our Notes limit or prohibit the payment of dividends on our common stock. Accordingly, we do not anticipate paying dividends on our common stock for the foreseeable future. The lack of dividend payments may adversely affect the market price of our common stock.

The market price of our common stock has been volatile since our initial public offering and may continue to be volatile.

Shares of our common stock may continue to experience substantial price volatility, including significant decreases, in response to a number of events, including:

- sales of our common stock by principal stockholders;
- our quarterly operating results;
- issuances of our common stock;
- future announcements concerning our business;
- our dividend policy;
- the failure of securities analysts to cover our common stock and/or changes in financial estimates and recommendations by securities analysts;
- actions of competitors;
- fluctuations in foreign currency exchange rates;
- changes in U.S. and foreign government regulation;
- general market, economic and political conditions; and
- natural disasters, terrorist attacks and acts of war.

On December 30, 2011, the last trading day in 2011, the closing price of our common stock was \$6.54 as compared with \$15.95 as of December 31, 2010. During the twelve months ended December 31, 2011, the lowest price of our common stock was \$6.30 and the highest price was \$25.51.

Some companies that have had volatile market prices for their securities have had securities class action lawsuits filed against them. Such lawsuits, should they be filed against us in the future, could result in substantial costs and a diversion of management's attention and resources. This could have a material adverse effect on our business, results of operations and financial condition.

Certain shareholders have significant influence over our business and significant transactions.

On the date we emerged from bankruptcy protection, referred to as the Effective Date, by operation of the plan of reorganization, all of our common stock then outstanding, par value \$0.01 or old common stock, was cancelled and approximately 82.6% of our new common stock, par value \$0.001 was issued to our lenders. Holders of our old common stock were issued approximately 17.4% of the new common stock, along with warrants to purchase up to an additional 10% of the new common stock outstanding on the Effective Date on a fully diluted basis. Also pursuant to the plan of reorganization, a majority of the directors serving on our reconstituted Board of Directors were nominated by certain of our then-lenders, including American Securities LLC (together with its affiliates, "American Securities") and Carl Marks Strategic Investments, L.P. (together

with its affiliates, “Carl Marks”). We also entered into the Director Nomination Agreements with certain of our then-lenders, including American Securities and Carl Marks, pursuant to which the applicable lender(s) may designate one individual for nomination to our Board of Directors, so long as the lender(s) continues to own at least 50% of the new common stock issued to such lender(s) under the plan of reorganization.

As of March 2, 2012, American Securities holds 14.3% of the outstanding shares of our common stock and Mr. Saiontz, a member of our Board of Directors, is a managing director of American Securities LLC. In addition, Carl Marks owns 12.0% of the outstanding shares of our common stock. Mr. Wilson, who is a general partner of Carl Marks Management Company, is also a member of our Board of Directors. As a result, Carl Marks and American Securities have a strong ability to influence our business, policies and affairs, and we cannot be certain that their interests will be consistent with the interests of other holders of our common stock.

Anti-takeover provisions could make it more difficult for a third-party to acquire us.

We have adopted a stockholder rights plan and issued a dividend of one right for each share of our common stock outstanding. Each right entitles the registered holder to purchase from us one one-thousandth of a preferred share, at a price of \$60.00 per one one-thousandth of a preferred share, subject to adjustment. Subject to limited exceptions, in the event a person (which includes affiliates and associates) acquires beneficial ownership of 15% or more of our common stock without prior approval of our Board of Directors, holders of the common stock, other than the acquirer, may exercise their rights to purchase our common stock (or, in certain circumstances, preferred shares or other of our similar securities) having a value equal to two times the exercise price of the right. Because the rights may substantially dilute the stock ownership of a person or group attempting to take us over without the approval of our Board of Directors, our rights plan could make it more difficult for a third party to acquire us (or a significant percentage of our outstanding capital stock) without first negotiating with our Board of Directors regarding that acquisition.

In addition, our Board of Directors has the authority to issue up to 1 million shares of preferred stock (of which 20,000 shares have been designated as Series A Junior Participating Preferred Stock) and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by the stockholders.

The rights of the holders of our common stock may be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock may have the effect of delaying, deterring or preventing a change in control of our company without further action by the stockholders and may adversely affect the voting and other rights of the holders of our common stock. Further, some provisions of our charter documents, including provisions eliminating the ability of stockholders to take action by written consent and limiting the ability of stockholders to raise matters at a meeting of stockholders without giving advance notice, may have the effect of delaying or preventing changes in control or management of our company, which could have an adverse effect on the market price of our stock. In addition, our charter documents do not permit cumulative voting, which may make it more difficult for a third party to gain control of our Board of Directors. Further, we are subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law, which will prohibit us from engaging in a “business combination” with an “interested stockholder” for a period of three years after the date of the transaction in which the person became an interested stockholder, even if such combination is favored by a majority of stockholders, unless the business combination is approved in a prescribed manner. The application of Section 203 also could have the effect of delaying or preventing a change in control of our company.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

As of December 31, 2011, we operate 38 facilities, of which 31 are manufacturing facilities in the following 14 countries: Argentina, Austria, Australia, Brazil, Canada, China, Finland, France, Germany, Italy, Japan, Mexico, Spain and the United States. Of the 31 manufacturing facilities that we operate, 11 are clothing manufacturing facilities, 18 are rolls manufacturing facilities and 2 are both clothing and rolls facilities. Almost all of our facilities are owned by us, rather than leased.

Excluded from the above property information is (i) one vacant former rolls manufacturing facility in Sherbrooke, Canada which was closed in the first quarter of 2009, and held for sale at December 31, 2010. We sold this property in January of 2011; and (ii) A vacant facility in Vietnam which is held for sale at December 31, 2010 and 2011.

We also have license agreements with two licensees that manufacture our roll covers products at their facilities in Japan and India. We have license agreements with one licensee that manufactures our clothing products in North America, various European countries and certain Pacific Rim countries.

ITEM 3. LEGAL PROCEEDINGS

We and our subsidiaries are involved in various legal matters, which have arisen in the ordinary course of business as a result of various labor claims, taxing authority reviews and other legal matters. As of December 31, 2011, we accrued an immaterial amount in our financial statements for these matters for which we believed the possibility of loss was either probable or possible, and we were able to estimate the damages or, under applicable income tax accounting guidance, it was more likely than not we would not be able to sustain a particular income tax position. These estimates have been developed in consultation with counsel and are based upon an analysis of potential results, assuming a combination of litigation and settlement strategies. It is possible, however, that future results of operations for any particular period could be materially affected by changes in our assumptions or the effectiveness of our strategies related to these proceedings.

Governmental Proceedings and Undertakings.

In November of 2011, the Federal Revenue Department of the Ministry of Finance of Brazil (“FRD”) issued a tax assessment against our indirect subsidiary, Xerium Technologies Brasil Indústria e Comércio S.A. (“Xerium Brazil”), challenging the goodwill recorded in the 2005 acquisition of Wangner Itelpa and Huyck Indústria e Comércio S.A. by Robec Brasil Participações Ltda. This assessment denies the amortization of that goodwill against net income for the years 2006 through 2010. In addition, the assessment seeks payment of approximately \$42.6 million (subject to currency exchange rates) of tax, penalties and interest. We believe the transactions in question (i) complied with Brazilian tax and accounting rules, (ii) were effected for a legitimate business purpose, to consolidate our operating activities in Brazil into one legal entity, and (iii) were properly documented and declared to Brazilian tax and corporate authorities. Based on the foregoing, Xerium Brazil filed a response disputing the tax assessment at the first administrative level of appeal within the FRD in December 2011.

Although there can be no assurances, we believe at the time of this filing, that it is more likely than not that we will prevail on every tax position under examination and therefore we have not accrued any amounts related to this assessment. Because we are at a preliminary stage of the process for resolving this dispute with the FRD, we cannot assure a favorable outcome and cannot currently estimate the timing of the final resolution of this matter. We believe we have meritorious defenses and will vigorously contest this matter. However, if the FRD’s initial position is sustained, the amount assessed would result in a material adjustment to our consolidated financial statements and would adversely impact our financial condition and results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is quoted on the New York Stock Exchange under the symbol "XRM". On March 2, 2012, there were approximately 86 stockholders of record of our common stock and the closing price of our common stock as reported by the New York Stock Exchange was \$7.71 per share. The following table lists the high and low sales prices for our common stock within the two most recent fiscal years. All stock prices have been adjusted to reflect the effective 20 to 1 reverse stock split of our common stock on May 25, 2010.

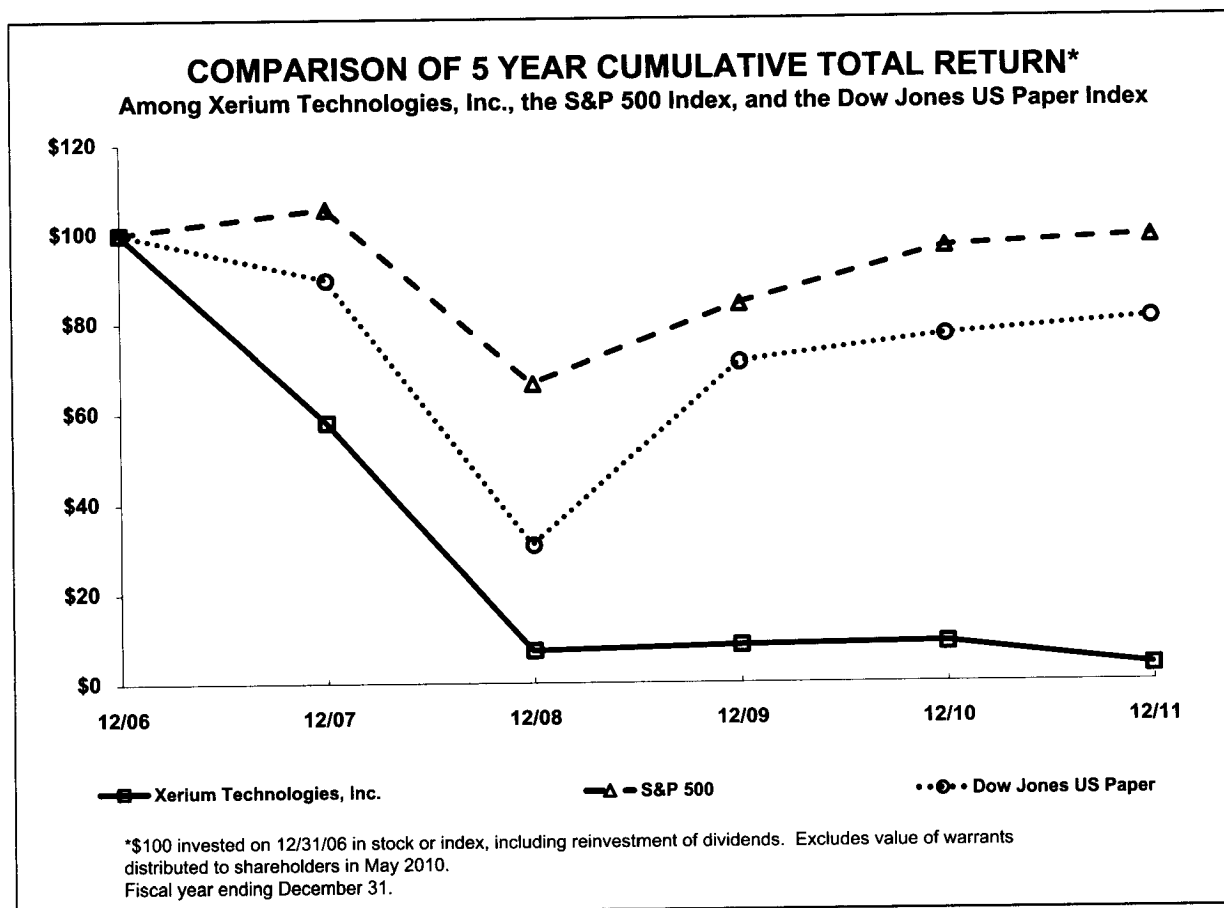
<u>Period</u>	<u>High</u>	<u>Low</u>
2011		
Fourth quarter	\$11.04	\$ 6.30
Third quarter	19.07	10.02
Second quarter	25.51	17.58
First quarter	24.45	15.75
2010		
Fourth quarter	\$16.24	\$12.32
Third quarter	14.16	9.66
Second quarter	28.00	13.15
First quarter	20.00	9.40

The following table presents information with respect to repurchases of common stock made by us during the three months ended December 31, 2011.

<u>Period</u>	<u>Total Number of Shares (or Units) Purchased(1)</u>	<u>Average Price Paid Per Share (or Unit)</u>	<u>Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs</u>
October of 2011	—	—	—	—
November of 2011	2,276	\$9.46	—	—
December of 2011	—	—	—	—
Total.	<u>2,276</u>	<u>\$9.46</u>	<u>—</u>	<u>—</u>

- (1) These shares of common stock were purchased by us from a retiring director in a private transaction. We purchased these shares in order to provide the director sufficient liquidity to satisfy tax obligations arising from the recognition of income upon his retirement from the Board of Directors at which time outstanding deferred stock units held by the director converted into shares of common stock.

The following information in this Item 5 of this Annual Report on Form 10-K is not deemed to be "soliciting material" or to be "filed" with the SEC or subject to Regulation 14A or 14C under the Exchange Act or to the liabilities of Section 18 of the Exchange Act, and will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent we specifically incorporate it by reference into such filing.



Our current credit facility prohibits, and our previous credit facility prohibited our payment of dividends and accordingly, we made no such payments during the years ended December 31, 2010 and 2011.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data should be read in conjunction with our financial statements and the related Notes to Consolidated Financial Statements. All per share amounts have been adjusted to reflect a 20-to-1 reverse stock split of our common stock occurring on May 25, 2010.

	Year ended December 31,				
	2011	2010	2009	2008	2007
	(in thousands, except per share data)				
Statement of operations data:					
Net sales	\$586,960	\$548,334	\$ 500,091	\$638,139	\$ 615,426
Costs and expenses:					
Cost of products sold	370,754	333,958	312,596	394,467	361,913
Selling	79,407	72,883	66,808	80,175	79,157
General and administrative	62,012	74,798	56,169	92,112	70,218
Restructuring and impairments	1,589	10,004	4,080	16,968	7,733
Research and development	12,097	11,427	11,309	11,740	10,189
Goodwill impairment	—	—	80,600	—	185,300
Curtailment/settlement gains	—	—	—	(39,968)	—
Total operating costs and expenses	525,859	503,070	531,562	555,494	714,510
Income (loss) from operations	61,101	45,264	(31,471)	82,645	(99,084)
Other income (expense):					
Interest expense, net	(39,150)	(56,795)	(67,300)	(58,504)	(53,126)
Loss on extinguishment of debt	(2,926)	—	—	—	—
Foreign exchange (loss) gain	(156)	1,668	(905)	6,356	(347)
Income (loss) before reorganization items and provision for income taxes	18,869	(9,863)	(99,676)	30,497	(152,557)
Reorganization items	—	(44,957)	—	—	—
Income (loss) before provision for income taxes	18,869	(54,820)	(99,676)	30,497	(152,557)
(Provision) benefit for income taxes	(10,679)	(18,266)	(12,317)	(3,901)	2,345
Net income (loss)	\$ 8,190	\$ (73,086)	\$ (111,993)	\$ 26,596	\$ (150,212)
Net income (loss) per common share—basic	\$ 0.54	\$ (7.29)	\$ (45.80)	\$ 11.60	\$ (67.20)
Net income (loss) per common share—diluted	\$ 0.54	\$ (7.29)	\$ (45.80)	\$ 11.60	\$ (67.20)
Cash dividends per common share	\$ —	\$ —	\$ —	\$ —	\$ 11.25

	Year ended December 31,				
	2011	2010	2009	2008	2007
Balance sheet data (at end of period):					
Unrestricted cash and cash equivalents	\$ 43,566	\$ 38,701	\$ 23,039	\$ 34,733	\$ 24,218
Total assets	665,721	689,942	693,511	818,097	899,027
Senior debt	467,137	475,563	583,564	606,200	657,506
Total debt	469,054	481,177	640,121	616,957	666,801
Total stockholders' (deficit) equity	(2,305)	18,735	(119,657)	(27,581)	(1,052)
Cash flow data:					
Net cash provided by operating activities	\$ 45,208	\$ 20,734	\$ 16,131	\$ 77,068	\$ 89,020
Net cash used in investing activities	(8,688)	(37,488)	(14,171)	(35,233)	(57,200)
Net cash (used in) provided by financing activities	(31,463)	32,626	(14,630)	(32,312)	(27,237)
Other financial data:					
Depreciation and amortization	\$ 43,686	\$ 41,281	\$ 41,867	\$ 45,928	\$ 45,540
Capital expenditures	30,154	27,928	19,532	39,028	47,859

The following table presents our unaudited consolidated statements of operations data for each quarter in the two years ended December 31, 2011. The information for each of these quarters is unaudited, but has been prepared on the same basis as the audited consolidated financial statements appearing elsewhere in this Annual Report on Form 10-K. Certain prior period balances have been reclassified to conform with the current year presentation. We believe that all necessary adjustments, consisting only of normal recurring adjustments, have been made to present fairly the unaudited quarterly results when read in conjunction with our audited consolidated financial statements and the notes thereto appearing elsewhere in this document. These operating results are not necessarily indicative of the results of operations that may be expected for any future period. All per share amounts have been adjusted to reflect a 20-to-1 reverse stock split of our common stock on May 25, 2010.

	For the Three Months Ended							
	Dec. 31, 2011	Sept. 30, 2011	June 30, 2011	Mar. 31, 2011	Dec. 31, 2010	Sept. 30, 2010	June 30, 2010	Mar. 31, 2010
	(in thousands, except per share data)							
Statement of operations data:								
Net sales	\$145,189	\$148,227	\$150,378	\$143,166	\$144,593	\$135,899	\$132,827	\$135,015
Costs and expenses:								
Cost of products sold	94,986	94,010	92,507	89,251	86,287	83,258	81,109	83,304
Selling	19,559	19,817	20,507	19,524	18,897	18,043	17,901	18,042
General and administrative	14,452	14,002	16,178	17,380	14,701	15,652	17,595	26,850
Restructuring and impairments	302	577	542	168	2,571	3,322	2,544	1,567
Research and development	3,177	2,907	2,925	3,088	2,720	2,887	2,952	2,868
Total operating costs and expenses	132,476	131,313	132,659	129,411	125,176	123,162	122,101	132,631
Income from operations	12,713	16,914	17,719	13,755	19,417	12,737	10,726	2,384
Other income (expense):								
Interest expense, net	(9,441)	(9,873)	(9,982)	(9,854)	(12,266)	(12,020)	(16,865)	(15,644)
Loss on extinguishment of debt	—	—	(2,926)	—	—	—	—	—
Foreign exchange gain (loss)	128	(289)	(159)	164	932	744	370	(378)
Income (loss) before reorganization items and provision for income taxes	3,400	6,752	4,652	4,065	8,083	1,461	(5,769)	(13,638)
Reorganization items	—	—	—	—	(583)	(799)	(29,192)	(14,383)
Income (loss) before provision for income taxes	3,400	6,752	4,652	4,065	7,500	662	(34,961)	(28,021)
Provision for income taxes	(967)	(3,264)	(3,030)	(3,418)	(6,762)	(4,318)	(5,050)	(2,136)
Net income (loss)	\$ 2,433	\$ 3,488	\$ 1,622	\$ 647	\$ 738	\$ (3,656)	\$ (40,011)	\$ (30,157)
Net income (loss) per common share—basic	\$ 0.16	\$ 0.23	\$ 0.11	\$ 0.04	\$ 0.05	\$ (0.24)	\$ (5.38)	\$ (12.05)
Net income (loss) per common share—diluted	\$ 0.16	\$ 0.23	\$ 0.11	\$ 0.04	\$ 0.05	\$ (0.24)	\$ (5.38)	\$ (12.05)

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the section titled "Risk Factors," the Consolidated Financial Statements and related Notes and other financial information appearing elsewhere in this Annual Report on Form 10-K.

Recent Developments

Global Economic Environment

Our operations are highly dependent upon the pulp and paper production industry and the degree to which the paper industry is affected by global economic conditions and the availability of credit.

Beginning in 2008 and continuing through most of 2009, the global paper industry experienced a sharp reduction in production levels, caused by the general slowdown in economic activity and related paper consumption during the same period and the paper manufacturers' reduction of excessive inventories. The slowdown of production was across most grades of paper production, but most notably in packaging and newsprint grades. For packaging grades, demand was directly related to broad manufacturing and transportation activity reduction, while newsprint demand has been declining over a number of years due to the greater prevalence of electronic media and was exacerbated during the recession by a reduction in print advertising. One of the results of this recession driven reduction in demand for paper products was that the paper manufacturers dramatically and quickly reduced production through curtailments of machines and complete mill shutdowns. These curtailments, which began in late 2008, served to reduce inventories and match output with demand. By early 2010, most mills and equipment not permanently shuttered had resumed production.

In the first half of 2011, global paper and board production continued the recovery that began in 2010, particularly in developing countries. As international shipments of manufactured goods increased, containerboard production recovered particularly strongly, contributing over 50% of the total global improvement. The paper and board production recovery stalled in the second half of 2011, particularly in Europe and South America. In the near term, we expect that global paper and board manufacturers' operating rates will remain near their second half 2011 levels. As a result of these factors, pricing pressures increased as 2011 progressed. We have endeavored to maintain our current pricing levels in both our clothing and rolls segments.

Overview

We are a leading global manufacturer and supplier of two types of consumable products used primarily in the production of paper—clothing and roll covers. Our operations are strategically located in the major paper-producing regions of North America, Europe, South America and Asia-Pacific.

Our products play key roles in the formation and processing of paper along the length of a paper-making machine. Paper producers rely on our products and services to help improve the quality of their paper, differentiate their paper products, operate their paper-making machines more efficiently and reduce production costs. Our products and services typically represent only a small percentage of a paper producer's overall production costs, yet they reduce costs by permitting the use of lower-cost raw materials and reducing energy consumption. Paper producers must replace clothing and refurbish or replace roll covers regularly as these products wear down during the paper production process. Our products are designed to withstand extreme temperature, chemical and pressure conditions, and are the result of a substantial investment in research and development and highly sophisticated manufacturing processes.

We operate in two principal business segments: clothing and roll covers. In our clothing segment, we manufacture and sell highly engineered synthetic textile belts that transport paper as it is processed on a paper-making machine. Clothing plays a significant role in the forming, pressing and drying stages of paper production.

Because paper-making processes and machine specifications vary widely, the clothing size, form, material and function is selected to fit each individual paper-making machine and process. In 2011, our clothing segment represented 66% of our net sales.

Our roll cover products provide a surface with the mechanical properties necessary to process the paper sheet in a cost-effective manner that delivers the sheet qualities desired by the paper producer. Roll covers are tailored to each individual paper-making machine and process, using different materials, treatments and finishings. In addition to manufacturing and selling new roll covers, we also provide refurbishment services for previously installed roll covers and manufacture spreader rolls. Additionally, we provide various related products and services to our customers, both directly and through third party providers, as a growing part of our overall product offering through our roll covers sales channels. In 2011, our roll cover segment represented 34% of our net sales.

Industry Trends and Outlook

Historically, demand for our products has been driven primarily by the volume of paper produced on a worldwide basis. We expect the growth of global paper production from 2012 to 2015 to be between 3% and 4% per annum. Generally, and over time, we expect growth in paper production to be greater in Asia-Pacific, South America and Eastern Europe than in the more mature North American and Western European regions where demand may potentially decline. Between 2008, especially the latter part of the year, and 2009, the global paper industry experienced a sharp reduction in production levels, caused by the general slowdown in economic activity and related paper consumption during the same period. In 2010 and 2011, global paper and board production began to recover from the economic recession and show growth, particularly in developing countries, although growth slowed in the second half of 2011. We believe that our increase in net sales volume in 2011 and 2010 as compared with 2009 reflects this recovery as well as the success of our new products.

The profitability of paper producers has historically been highly cyclical due to wide swings in the price of paper, driven to a high degree by the oversupply of paper during periods when paper producers have more aggregate capacity than the market requires. A sustained downturn in the paper industry, either globally or in a particular region, can cause paper manufacturers to reduce production or cease operations, which could adversely affect our net sales and profitability. Since 2000, paper producers have taken actions that seek to structurally improve the balance between the supply of and demand for paper. As part of these efforts, they have permanently shut down many paper-making machines or entire manufacturing facilities. Papermakers continue to experience low levels of profitability. We believe that further consolidation among papermakers, reduction in the number of paper producers, and shutdowns of paper-making machines or facilities will occur in Europe and North America until there is a better balance between supply and demand for paper and the profit levels of paper producers improve. This rebalancing has been accelerated since the most recent global economic recession. Over a number of years, paper consumption growth, particularly in South America and Asia-Pacific, is expected to drive an increase in the global production rates required to maintain balance between supply and demand. It is highly likely, however, that the recession-led consumption slow-down and related effect on global paper production will continue in the near term. Also affecting machine curtailments are structural productivity gains from improved products that we and our competitors supply.

Global paper production growth that does occur would be moderated by the level of industry consolidation and paper-machine shutdown activity that is a continuing underlying trend in North America and Western Europe. We also believe that, in addition to industry consolidation and paper machine shutdown activity in North America and Western Europe, the trend towards new paper machine designs with fewer rolls and market recognition of the extended life of our roll cover products has been and will continue to negatively impact demand for these products and their volume potential. However, we believe volume declines would be partially offset by our introduction of new products with the extended life qualities that our customers desire and increasing market share of proprietary products such as our SmartRoll™. Additionally, we are seeing a trend that paper producers are placing an increasing emphasis on maintenance cost reduction and, as a result, are extending the life of roll covers through additional maintenance cycles before replacing them.

We anticipate that pricing pressure for our products may continue with the consolidation among paper producers and as the shift of paper production growth in Asia-Pacific develops. In response to this pricing pressure, we expect to focus our research and development efforts on new products that our customers value. In addition, we will continue to enhance and deploy our value added selling approach as part of our strategy to differentiate our products, while at the same time we remain focused on cost reduction and efficiency programs. The negative paper industry trends described above are likely to continue. Although there appears to be a sustained, but slow recovery underway, we believe that the paper industry will experience increased emphasis on cost reduction, continued paper-machine shutdown activity, and reduced availability of credit than would have been the case in the absence of the economic downturn. These industry dynamics could negatively impact our business, results of operations and financial condition.

Net sales and Expenses

Net sales in both our clothing and roll covers segments are primarily driven by the following factors:

- The volume of worldwide paper production;
- Our ability to introduce new products that our customers value;
- Advances in the technology of our products, which can provide value to our customers by improving the efficiency of paper-making machines and reduce their manufacturing costs;
- Our ability to provide products and services which reduce paper-making machine downtime while at the same time allowing the manufacture of high quality paper products; and
- The impact of currency fluctuations.

Net sales in our roll covers segment include our mechanical services business. We have expanded this business in response to demand from paper producers that we perform work on the internal mechanisms of a roll while we refurbish or replace a roll cover. In our clothing segment, a small portion of our business has been conducted pursuant to consignment arrangements under which we do not recognize a sale of a product to a customer until the customer places the product into use, which typically occurs some period after the product is shipped to the customer or to a warehouse location near the customer's facility. As part of the consignment agreement we deliver the goods to a location designated by the customer. In addition, the customer and we agree to a "sunset" date, which represents the date by which the customer must accept all risks and rewards of ownership of the product and payment terms begin. For consignment sales, revenue is recognized on the earlier of the actual product installation date or the "sunset" date.

Our operating cost levels are impacted by total sales volume, the impact of inflation, foreign currency fluctuations and the level and impact of cost reduction programs.

The level of our cost of products sold is primarily attributable to labor costs, raw material costs, product shipping costs, plant utilization and depreciation, with labor costs constituting the largest component. We invest in facilities and equipment that enable innovative product development and improve production efficiency and costs. Recent examples of capital spending for such purposes include faster weaving looms and seaming machines with accurate electronic controls, automated compound mixing equipment and computer-controlled lathes and mills.

The level of research and development spending is driven by market demand for technology enhancements, including both specific customer needs and general market requirements, as well as by our own analysis of applied technology opportunities. With the exception of purchases of equipment and similar capital items used in our research and development activities, all research and development is expensed as incurred. Research and development expenses were \$12.1 million, \$11.4 million and \$11.3 million for the years ended December 31, 2011, 2010 and 2009, respectively.

Foreign Exchange

We have a geographically diverse customer base. In 2011, we generated approximately 36% of our net sales in North America, 34% in Europe, 9% in South America, 19% in Asia-Pacific and 2% in the rest of the world.

A substantial portion of our net sales is denominated in Euros or other currencies. As a result, changes in the relative values of U.S. Dollars, Euros and other currencies affect our reported levels of net sales and profitability as the amounts are translated into U.S. Dollars for reporting purposes. In particular, decreases in the value of the U.S. Dollar relative to the value of the Euro and these other currencies positively impact our levels of revenue and profitability because the translation of a certain number of Euros or units of such other currencies into U.S. Dollars for financial reporting purposes will represent fewer U.S. Dollars.

For certain transactions, our net sales are denominated in U.S. Dollars but all or a substantial portion of the associated costs are denominated in a different currency. As a result, changes in the relative values of U.S. Dollars, Euros and other currencies can affect the level of the profitability of these transactions. The largest proportion of such transactions consist of transactions in which the net sales are denominated in or indexed to U.S. Dollars and all or a substantial portion of the associated costs are denominated in Euros, Reals or other currencies.

Currency fluctuations have a greater effect on the level of our net sales than on the level of our income (loss) from operations. For example, in 2011 as compared to 2010, the change in the average value of the U.S. Dollar against most of the currencies we conduct our business in resulted in net increases of \$16.6 million in net sales and net decreases of \$1.6 million in income from operations. Although the 2011 results reflect a period in which the average value of the U.S. Dollar decreased against the Euro as compared to 2010, we would expect an opposite effect in a period in which the value of the U.S. Dollar increases.

During 2011, we conducted business in 9 foreign currencies. The following table provides the average exchange rate in 2011 and 2010 of the U.S. Dollar against each of the four foreign currencies in which we conduct the largest portion of our operations.

<u>Currency</u>	<u>Average exchange rate of the U.S. Dollar in 2011</u>	<u>Average exchange rate of the U.S. Dollar in 2010</u>
Euro	\$1.39 = 1 Euro	\$1.33 = 1 Euro
Brazilian Real	\$0.60 = 1 Brazilian Real	\$0.57 = 1 Brazilian Real
Canadian Dollar	\$1.01 = 1 Canadian Dollar	\$0.97 = 1 Canadian Dollar
Australian Dollar	\$1.03 = 1 Australian Dollar	\$0.92 = 1 Australian Dollar

Over the last year, approximately 40% of our operations have been conducted in Euros, approximately 8% in the Brazilian Real (although a significant portion of Brazil net sales are in US Dollars) and approximately 6% in the Canadian Dollar.

To mitigate the risk of transactions in which a sale is made in one currency and associated costs are denominated in a different currency, we utilize forward currency contracts in certain circumstances to lock in exchange rates with the objective that the gain or loss on the forward contracts will approximate the loss or gain that results from the transaction or transactions being hedged. We determine whether to enter into hedging arrangements based upon the size of the underlying transaction or transactions, an assessment of the risk of adverse movements in the applicable currencies and the availability of a cost effective hedge strategy. To the extent we do not engage in hedging or such hedging is not effective, changes in the relative value of currencies can affect our profitability.

Domestic and Foreign Operating Results:

The following is an analysis of our domestic and foreign income from operations during the year ended December 31, 2011 and 2010 and a discussion of the results of operations during those periods:

	Year Ended December 31,	
	2011	2010
Domestic	\$ 7,504	\$ 4,678
Foreign	53,597	40,586
Total	<u>\$61,101</u>	<u>\$45,264</u>

Our domestic income from operations represented approximately 31% of total net sales and the our foreign operations represented approximately 69% of total net sales during the year ended December 31, 2011. During the year ended December 31, 2011, domestic gross margin rates were lower than foreign gross margin rates, primarily due to product mix and market differences. In addition, domestic selling, general and administrative and research and development expenses were higher as a percentage of net sales, as certain large corporate overhead costs were included in the domestic results.

Cash flows from the above foreign income from operations typically remains reinvested in the foreign subsidiaries. However, there is no legal restriction or material adverse consequence for repatriating the cash flows to the domestic subsidiaries to assist in debt repayment, capital expenditures and other expenses of our operations.

Debt Refinancing

On May 26, 2011, we completed a refinancing transaction, which replaced certain of our then outstanding indebtedness with an offering of \$240 million of our 8.875% senior unsecured notes due 2018 and a new approximately \$278 million multi-currency senior secured credit facility, comprised of approximately \$248 million of senior secured term loans and a committed \$30 million senior secured revolving credit facility. The goal of the refinancing was to extend the maturity of, and fix the interest rate on, a portion of our debt, while providing lower interest rates and increased operational flexibility. See "Credit Facility and Notes" for a discussion of the notes and current credit facility.

Chapter 11 Filing, Emergence and Plan of Reorganization

On March 30, 2010, we and certain of our subsidiaries filed voluntary petitions for relief under Chapter 11 of Title 11 of the United States Code, 11 U.S.C. §§ 101-1532, and on April 1, 2010, following approval by the Bankruptcy Court, we entered into a debtor-in-possession financing facility consisting of a \$20 million revolving credit facility and \$60 million term loan (the "Exit Facility"). On May 25, 2010 (the "Effective Date"), our amended joint prepackaged plan of reorganization (the "Plan") became effective, at which time we emerged from Chapter 11. Pursuant to the Plan, on the Effective Date:

- 20 million shares of our new common stock, par value \$0.001 were authorized, of which an aggregate of 14,970,050 shares were issued and outstanding, as described below. In addition, 1,000,000 shares of preferred stock, par value \$0.001, were authorized, of which 20,000 shares were designated as Series A Junior Participating Preferred Stock;
- All of the shares of our common stock then outstanding, par value \$0.01, or old common stock, were canceled and replaced with 2,566,150 shares of our new common stock, which was equivalent to a 20 to 1 reverse split of our old common stock;
- The lenders under our pre-petition credit facility and the interest rate swap termination counterparties received, among other things, their ratable shares of (a) \$10 million in cash, (b) \$410 million in principal amount of term notes, issued pursuant to our post-reorganization senior credit facility (the "Prior Credit Facility"), and (c) 12,403,900 shares of new common stock;

- Holders of our old common stock also received four-year warrants to purchase an aggregate of 1,663,760 shares of new common stock at an exercise price of \$19.55 per share, representing approximately 0.0324108 warrants for each share of old common stock.

As previously disclosed in our filings with the SEC, we entered into a number of material agreements and engaged in a series of transactions on the Effective Date, including (i) the Prior Credit Facility (ii) an exit facility, which rolled over and replaced the DIP Facility (the “Exit Facility”) (iii) a Rights Agreement, (iv) a Registration Rights Agreement with certain of our stockholders, and (v) Director Nomination Agreements with certain of our stockholders.

Cost Reduction Programs

An important part of our strategy is to seek to reduce our overall costs and improve our competitiveness. As a part of this effort, we engage in cost reduction programs, which are designed to improve the cost structure of our global operations in response to changing market conditions. These cost reduction programs include headcount reductions throughout the world as well as plant closures that have rationalized production among our facilities to better enable us to meet customer demands. Cost savings have been realized in labor costs and other production overhead, other components of costs of products sold, general and administrative expenses and facility costs. The majority of the cost savings begin at the time of the headcount reductions and plant closure, with the remaining cost savings recognized over subsequent periods. Cost savings from headcount reductions have not been offset by related increases in other expenses. Cost savings related to plant closures have been partially offset by the reduction of revenues associated with those closed facilities in subsequent periods and additional costs incurred in the facilities that assumed the operations of the closed facility.

Our cost reduction efforts between 2002 and 2011 included the closing of 14 manufacturing facilities. During this same period, our headcount was lowered by almost 800 individuals as a result of these actions.

In 2009, we charged a total of \$4.1 million to restructuring and impairments expense related to the continual streamlining of our operating structure and asset impairments, partially offset by a gain on sale of our rolls manufacturing facility in Sweden.

In 2010, we incurred restructuring expenses of approximately \$10.0 million in the aggregate, primarily related to the North Bay, Ontario closure, the closure of a rolls plant in Germany, asset impairment charges in Vietnam and to headcount reductions resulting from the integration of the regional management structure in North America and Europe.

In 2011, we incurred restructuring expenses of approximately \$1.6 million, primarily related to the continued streamlining of our cost structure and operations. We expect to continue to review our business to determine if additional actions can be taken to further improve our cost structure. We currently estimate restructuring expenses of approximately \$5.0 to \$10.0 million during 2012, primarily related to a continuation of streamlining our operating structure. Actual restructuring costs for 2012 may differ substantially from our estimates at this time, depending on actual operating results in 2012 and the timing of any restructuring activity.

Results of Operations

The tables that follow set forth for each of the three years in the period ended December 31, 2011, 2010 and 2009 certain consolidated operating results:

	Year ended December 31,		
	2011	2010	2009
		(in millions)	
Net sales	\$586,960	\$548,334	\$ 500,091
Cost of products sold	370,754	333,958	312,596
Selling expenses	79,407	72,883	66,808
General and administrative expenses	62,012	74,798	56,169
Restructuring and impairments expenses	1,589	10,004	4,080
Research and development expenses	12,097	11,427	11,309
Goodwill impairment	—	—	80,600
Income (loss) from operations	61,101	45,264	(31,471)
Interest expense, net	(39,150)	(56,795)	(67,300)
Loss on debt extinguishment	(2,926)	—	—
Foreign exchange (loss) gain	(156)	1,668	(905)
Income (loss) before reorganization expenses and provision for income taxes	18,869	(9,863)	(99,676)
Reorganization expenses	—	(44,957)	—
Income (loss) before provision for income taxes	18,869	(54,820)	(99,676)
Provision for income taxes	(10,679)	(18,266)	(12,317)
Net income (loss)	\$ 8,190	\$ (73,086)	\$ (111,993)

Year Ended December 31, 2011 Compared to Year Ended December 31, 2010.

Net Sales. Net sales for the year ended December 31, 2011 increased by \$38.6 million, or 7.0%, to \$586.9 million from \$548.3 million for the year ended December 31, 2010. During 2011 and 2010, approximately 66% of our net sales were in our clothing segment and approximately 34% were in our roll covers segment.

In our clothing segment, net sales increased by \$26.7 million, or 7.4%, to \$386.4 million from \$359.7 million compared to the same period last year. The increase is primarily due to higher sales volume of \$15.0 million, primarily in our North America and Asia-Pacific regions, and favorable currency effects of \$11.7 million, partially offset by decreased sales volume in our European region.

In our roll covers segment, net sales increased by \$11.9 million, or 6.3%, to \$200.5 million from \$188.6 million compared to the same period last year. The increase is primarily due to higher sales volume of \$7.0 million primarily in our North America and Asia-Pacific regions, and favorable currency effects of \$4.9 million, partially offset by decreased sales volume in our European and South American regions.

Cost of Products Sold. Cost of products sold for the year ended December 31, 2011 increased by \$36.8 million, or 11.0%, to \$370.8 million from \$334.0 million for the year ended December 31, 2010.

In our clothing segment, cost of products sold, as a percentage of revenue, increased by 2.2% to 62.6% from 60.4% compared to the prior year. Cost of products sold increased \$24.2 million or 11.2%. This increase is primarily driven by unfavorable currency effects of \$9.4 million, higher sales volume resulting in increased cost of products sold of \$6.1 million and unfavorable regional sales mix due to higher sales growth in regions with lower margins. In addition, fixed costs increased by \$3.1 million, primarily due to the increase in depreciation, repairs and maintenance, the impact of inflation and an increase in inventory reserves.

In our roll covers segment, cost of products sold, as a percentage of revenue, increased by 2.5% to 65.5% from 63.0% compared to the prior year. Cost of products sold increased \$12.6 million or 10.6%. This increase is driven by unfavorable currency effects of \$2.9 million, increased sales volume resulting in increased cost of \$3.1 million, increased material cost of \$5.0 million, primarily due to higher purchase costs and higher sales growth in product lines with lower margins. In addition, fixed costs increased by \$1.1 million.

Selling Expenses. For the year ended December 31, 2011 selling expenses increased by \$6.5 million, or 8.9%, to \$79.4 million from \$72.9 million compared to the prior year, primarily due to unfavorable currency effects of \$3.1 million, \$1.6 million increase in compensation and \$1.5 million higher sales commissions due to higher sales volume and related costs.

General and Administrative Expenses. For the year ended December 31, 2011, general and administrative expenses decreased by \$12.8 million, or 17.1%, to \$62.0 million from \$74.8 million compared to the prior year. The decrease is primarily due to (1) lower bank, consulting and legal fees of \$9.9 million as a result of the reorganization in 2010, (2) a decrease of \$4.2 million in management incentive compensation from 2010 to 2011, (3) a decrease of \$3.1 million due to additional stock compensation expense recorded in 2010 as a result of the acceleration of certain performance restricted stock plans in connection with the reorganization in 2010 and a decrease in stock compensation related to various amendments to and the expected payout of certain performance stock compensation plans in 2011, (4) the reversal of \$1.1 million in 2011 related to a previously accrued value added tax amount in South America as a result of a favorable ruling by the taxing authorities in 2011 and (5) a decrease of \$0.8 million in environmental costs in 2011. These decreases were partially offset by unfavorable currency effects of \$2.5 million and an increase in bad debt expense of \$2.5 million, primarily related to a reduction in the required reserve in 2010 and specific losses related to the bankruptcies of certain customers in 2011.

Restructuring and Impairment Expenses. For the year ended December 31, 2011, restructuring and impairment expenses decreased by \$8.4 million, or 84.0%, to \$1.6 million from \$10.0 million for the year ended December 31, 2010. For the most part, restructuring expenses in 2011 and 2010 resulted from our long-term strategy to reduce production costs and improve long-term competitiveness as described above under “Cost Reduction Programs” by closing and/or transferring production from certain of our manufacturing facilities and through headcount reductions. For the year ended December 31, 2011, restructuring expenses included \$1.1 million related to the relocation of equipment and the wind up of the North Bay, Canada pension plan, as this facility was closed and sold in 2010 and approximately \$0.8 million in various other restructuring expenses. Partially offsetting these charges was a \$0.3 million gain recorded as a result of the sale of the Sherbrooke, Canada facility.

Interest Expense, Net. Net interest expense for the year ended December 31, 2011 decreased by \$17.6 million or 31.0%, to \$39.2 million from \$56.8 million for the year ended December 31, 2010. The decrease was primarily attributable to \$9.7 million of interest rate swaps being fully amortized at December 31, 2010, a \$5.9 million lower interest expense due to lower debt balances and interest rates from 2010 to 2011, and \$3.6 million lower amortization of deferred financing costs in 2011, primarily as a result of \$3.9 million in amortization of the Debtor in Possession deferred financing fees in 2010 prior to the refinancing in 2010. These decreases were partially offset by unfavorable currency effects of \$0.9 million and a decrease in interest income of \$0.7 million, primarily as a result of lower balances in high-yield cash accounts in 2011.

Loss on Debt Extinguishment. The loss on debt extinguishment of \$2.9 million in the year ended December 31, 2011 resulted from the refinancing of debt that closed on May 26, 2011. (See Note 6 of the Condensed Consolidated Financial Statements and “Credit Facility and Notes” below for further discussion on the refinancing). In 2010, as part of the reorganization, \$14.4 million represented loss on debt extinguishment, and is included in reorganization expenses on the Condensed Consolidated Statements of Operations. See below for further discussion.

Foreign Exchange Gain (Loss). For the year ended December 31, 2011, we had a foreign exchange loss of \$(0.2) million. For the year ended December 31, 2010 we had a foreign exchange gain of \$1.7 million. Foreign exchange gains and losses are primarily the result of transactions made by an entity in their non-functional currency and hedging activities.

Reorganization Expenses. Reorganization expenses amounting to \$45.0 are presented separately in our Condensed Consolidated Statements of Operations for the year ended December 31, 2010 and represent expenses that we had identified as directly relating to legal and professional fees of \$16.3 million, a loss on extinguishment of debt of \$14.4 million and \$14.3 million related to the expenses incurred in connection with the Chapter 11 proceedings in 2010. As the proceedings were completed in May of 2010, we had no reorganization expenses in 2011.

Provision for Income Taxes. For the years ended December 31, 2011 and 2010, the provision for income taxes was \$10.7 million and \$18.3 million, respectively. We recorded lower tax expense in 2011 as compared with 2010 principally due to non-recurring tax expense recorded in 2010 to increase our gross uncertain tax position which did not affect 2011. Our effective income tax rate for the year ended December 31, 2011 was 56.6% as compared with our effective rate for the year ended December 31, 2010 of (33.3)%. Our effective income tax rate is primarily impacted by income we earn in tax paying jurisdictions relative to income we earn in non-tax paying jurisdictions. The majority of income recognized for purposes of computing our effective tax rate is earned in countries where the statutory income tax rates range from 25% to 41%; however, permanent income adjustments recorded against pre-tax earnings may result in an effective tax rate that is higher or lower than the statutory tax rate in these jurisdictions. We generate losses in certain jurisdictions for which we receive no tax benefit as the deferred tax assets in these jurisdictions (including net operating losses) are fully reserved in our valuation allowance. For this reason, we recognize minimal income tax expense or benefit in these jurisdictions, of which the most material jurisdictions are the United States, the United Kingdom and Australia. Due to these reserves, the geographic mix of our pre-tax earnings has a direct correlation with how high or low our annual effective tax rate is relative to consolidated earnings.

In November 2011, Xerium Technologies Brasil Indústria e Comércio S.A., a Brazilian indirect subsidiary, received a notice of proposed income tax assessment from the Federal Revenue Department of the Ministry of Finance of Brazil totaling approximately \$42.6 million (subject to currency exchange rates). Although there can be no assurances, we believe at the time of this filing, that it is more likely than not that we will prevail on every tax position under examination and therefore we have not accrued any amounts related to this assessment. See “Legal Proceedings” and Note 9 in the accompanying audited consolidated financial statements for further discussion.

Year Ended December 31, 2010 Compared to Year Ended December 31, 2009.

Net Sales. Net sales for the year ended December 31, 2010 increased by \$48.2 million, or 9.6%, to \$548.3 million from \$500.1 million for 2009. For the year ended December 31, 2010, approximately 66% of our net sales was in our clothing segment and 34% was in our roll cover segment.

In our clothing segment, net sales for the year ended December 31, 2010 increased by \$28.3 million, or 8.5%, to \$359.7 million from \$331.4 million for 2009 primarily due to higher sales volume in Europe, North America, South America and Asia-Pacific partially offset by unfavorable currency effects of \$0.6 million. Overall pricing levels in our clothing segment remained relatively constant during the years ended December 31, 2010 and 2009.

In our roll covers segment, net sales for the year ended December 31, 2010 increased by \$19.9 million, or 11.8%, to \$188.6 million from \$168.7 million for the year ended December 31, 2009, primarily due to higher sales volumes in Europe, North America, South America and Asia-Pacific and an increase in overall pricing levels of approximately \$1.3 million. These increases were partially offset by unfavorable currency effects of \$2.1 million.

Cost of Products Sold. Cost of products sold for the year ended December 31, 2010 increased by \$21.4 million, or 6.8%, to \$334.0 million from \$312.6 million for the year ended December 31, 2009.

In our clothing segment, cost of products sold increased by \$12.8 million, or 6.3%, to \$215.1 million for the year ended December 31, 2010 from \$202.3 million for the year ended December 31, 2009 primarily due to approximately \$9.1 million in higher sales volumes in Europe, North America, South America and Asia-Pacific during the year ended December 31, 2010 compared with the year ended December 31, 2009 and to unfavorable currency effects of \$2.3 million.

In our roll covers segment, cost of products sold increased by \$8.6 million, or 7.8%, to \$118.9 million for the year ended December 31, 2010 from \$110.3 million for the year ended December 31, 2009 primarily due to approximately \$10.1 million in higher sales volumes in Europe, North America, South America and Asia-Pacific during the year ended December 31, 2010 as compared with the year ended December 31, 2009 offset by favorable currency effects of \$1.3 million.

Selling Expenses. For the year ended December 31, 2010, selling expenses increased by \$6.0 million, or 9.0%, to \$72.8 million from \$66.8 million for the year ended December 31, 2009. The increase was primarily due to an increase of approximately \$5.3 million related to increased headcount and salaries and higher sales commissions as a result of higher sales volumes during the year ended December 31, 2010 as compared with the year ended December 31, 2009 and unfavorable currency effects of \$0.8 million.

General and Administrative Expenses. For the year ended December 31, 2010, general and administrative expenses increased by \$18.6 million, or 33.1%, to \$74.8 million from \$56.2 million for the year ended December 31, 2009. The increase was approximately half due to the result of gains recorded in 2009 that were absent in 2010 such as (1) a \$3.4 million reversal that was recorded in 2009 for environmental expense related to remediation costs in Australia, (2) a \$2.3 million decrease that was recorded in 2009 in litigation accruals for Brazilian labor matters and other legal matters, and (3) a \$3.8 million decrease that was recorded in 2009 in provisions for doubtful accounts based on collections and lower reserves required for certain North American customers who had filed for bankruptcy. Additionally contributing to the increased expenses in 2010 as compared with 2009 were (1) increased financial restructuring costs of \$1.2 million (These costs related to the amendment of our senior credit facility in effect prior to the Effective Date and were \$9.9 million in 2010 and \$8.7 million in 2009), (2) increased stock based and management incentive compensation expenses of \$6.7 million primarily related to an amendment to the terms of all performance-based restricted stock units outstanding on December 24, 2009 to vest upon our successful debt restructuring, which occurred on the May 12, 2010, the date our Plan was confirmed by the Bankruptcy Court, and to the management incentive program approved in the third quarter of 2010, and (3) increased payroll related costs of \$1.6 million due to our resumption of the employer match on our 401(k) plan effective the beginning of 2010. Currency translation effects remained relatively constant from 2009 to 2010.

Restructuring and Impairments Expenses. For the year ended December 31, 2010, restructuring expenses increased by \$5.9 million, or 144.0%, to \$10.0 million from \$4.1 million for the year ended December 31, 2009 primarily due to the closure of our roll covers facility in North Bay, Ontario, the closure of one rolls plant in Germany, the closure of our Massachusetts office and an asset impairment related to our Vietnam facility. For the most part, restructuring expenses resulted from our long-term strategy to reduce costs and improve long-term competitiveness as described above under “Cost Reduction Programs” by closing and/or transferring production from certain of our manufacturing facilities and through headcount reductions. For the year ended December 31, 2010, restructuring expenses consisted of severance costs, facility costs and asset impairments of \$4.7 million, \$2.5 million and \$2.8 million, respectively.

Goodwill Impairment. There was no goodwill impairment recorded during the year ended December 31, 2010. As of December 31, 2009, we recorded a non-cash charge for goodwill impairment of \$80.6 million related to our roll covers segment based on assessments performed at that date. In accordance with ASC Topic 350, *Intangibles—Goodwill and other Intangible Assets* (“Topic 350”), we are required to test goodwill at least

annually for impairment, which we do each year at December 31. Applying the guidance in Topic 350, we determined that as of December 31, 2009, goodwill for the roll covers segment was impaired primarily due to the adverse effect of our credit issues and the effects of the current global economic environment.

Interest Expense, Net. Net interest expense for the year ended December 31, 2010 decreased by \$10.5 million, or 15.6%, to \$56.8 million from \$67.3 million for the year ended December 31, 2009. The decrease is primarily attributable to the termination of all of our interest rate swaps on December 31, 2009, which carried fixed interest rates that were higher than variable interest rates and to lower interest expense due to lower debt balances under the Prior Credit Facility. Partially offsetting the decreases is \$9.7 million during the year ended December 31, 2010 as compared with \$3.8 million during the year ended December 31, 2009 from accumulated other comprehensive income to interest expense. These amounts represent the mark to market changes in the swaps in 2009 and the amortization in 2010 of the balance remaining in other comprehensive income relating to these swaps.

Foreign Exchange Gain (Loss). For the year ended December 31, 2010, we had a foreign exchange gain of \$1.7 million compared to a \$(0.9) million loss for the year ended December 31, 2009. Foreign exchange gains and losses are primarily the result of transactions made by an entity in their non-functional currency, hedging activities and U.S. Dollar denominated debt held by foreign entities.

Reorganization Items. Reorganization items are presented separately in our consolidated statements of operations for the year ended December 31, 2010 and represent expenses that we have identified as directly relating to our chapter 11 proceedings which took place in the early part of 2010. Reorganization items of \$45.0 million consisted of legal and professional fees of \$16.3 million, a loss on the extinguishment of debt of \$14.4 million and the write-off of deferred financing costs of \$14.3 million related to the pre-petition senior credit facility.

Provision for Income Taxes. For the years ended December 31, 2010 and 2009, the provision for income taxes was \$18.3 million and \$12.3 million, respectively. Certain of our foreign and U.S. subsidiaries incurred losses during the years ended December 31, 2010 and 2009, for which no benefit was recognized due to established valuation allowances on deferred tax assets. We recorded income tax expense for 2010, even though we had a consolidated pre-tax loss, principally due to (i) losses that were incurred domestically and in certain foreign jurisdictions for which no corresponding tax benefit was recognized as the net operating losses that were created for tax purposes in these jurisdictions were fully reserved for book purposes, (ii) the establishment of uncertain tax reserves for certain of our foreign historical tax positions including the \$3.9 million impairment of a German deferred tax asset that we believe to be subject to possible forfeiture, based on a recent tax ruling with respect to a previously available restructuring exemption, and (iii) the disallowance of certain deductions for costs incurred as part of our reorganization. We recorded income tax expense for 2009, even though we had a consolidated pre-tax loss, principally due to (i) losses that were incurred domestically and in certain foreign jurisdictions for which no corresponding tax benefit was recognized as the net operating losses that were created for tax purposes in these jurisdictions were fully reserved for book purposes, (ii) goodwill impairment recorded domestically and in certain foreign jurisdictions for which no corresponding tax benefit was recognized and (iii) the establishment in 2009 of valuation allowances in Canada, China and the United Kingdom.

Liquidity and Capital Resources

Our principal liquidity requirements are for debt service, working capital and capital expenditures. We plan to use cash on hand, cash generated by operations and, should it become necessary, access to our revolving credit facility, as our primary sources of liquidity. Our operations are highly dependent upon the paper production industry and the degree to which the paper industry is affected by global economic conditions and the availability of credit. Demand for our products could decline if paper manufacturers are unable to obtain required financing or if economic conditions cause additional mill closures. In addition, the impact of the most recent global economic recession and the ensuing lack of availability of credit may affect our customers' ability to pay their debts.

In late 2009 and early 2010, our liquidity and capital resources were constrained by our non-compliance with the terms of our pre-petition credit facility and subsequent prepackaged Chapter 11 proceedings. As previously disclosed, prior to the filing of our Chapter 11 petitions on March 30, 2010, we were not in compliance with certain of the financial covenants under our pre-petition credit facility for the quarters ended September 30, 2009 and December 31, 2009. From September 29, 2009, waiver fees were paid to the lenders and the outstanding balance under the pre-petition credit facility bore interest at a rate that was 1.0% per year in excess of the non-default rate otherwise payable during that period under the facility. On March 30, 2010, we and certain of our subsidiaries filed for Chapter 11 protection. See “—Chapter 11 Filing, Emergence and Plan of Reorganization” for further information regarding our Chapter 11 proceedings. Upon our emergence from Chapter 11 on May 25, 2010, our Prior Credit Facility and Exit Facility replaced our pre-petition credit facility and our DIP Facility. See “Credit Facility and Notes” for further discussion of our current borrowings.

Net cash provided by operating activities was \$45.2 million for the year ended December 31, 2011 and \$20.7 million for the year ended December 31, 2010. The \$24.5 million increase is due to improved cash earnings from the year ended December 31, 2010 to the year ended December 31, 2011, partially offset by an increase in working capital for that same period. Net cash provided by operating activities was \$20.7 million for the year ended December 31, 2010 and \$16.1 million for the year ended December 31, 2009. The \$4.6 million increase is primarily due to improved cash earnings during the year ended December 31, 2010. The increase in 2010 was after a reduction of cash reorganization items of approximately \$16.2 million.

Net cash used in investing activities was \$8.7 million for the year ended December 31, 2011 and \$37.5 million for the year ended December 31, 2010. The change of \$28.8 million was primarily due to the increase of \$13.7 million of restricted cash balances in 2010 as a result of the Prior Credit Facility in place at December 31, 2010 and the release of \$13.7 million in 2011 to unrestricted cash balances in accordance with the Credit Facility. In addition, proceeds from the sale of fixed assets increased by \$3.6 million from 2010 to 2011, primarily as a result of the sale of our Geelong, Australia facility. These increases were partially offset by a \$2.2 million increase in capital equipment expenditures during the year ended December 31, 2011 as compared with the same period in 2010.

Net cash used by financing activities was \$31.5 million for the year ended December 31, 2011 and net cash provided by financing activities was \$32.6 million for the year ended December 31, 2010. The change of \$64.1 million was primarily the result of a decrease in net proceeds from borrowings of debt of \$55.0 million in the year ended December 31, 2011 from the year ended December 31, 2010 primarily as a result of the issuance of \$60.0 million under the Exit Facility in 2010, and the payment of higher deferred financing costs of \$9.1 million in the year ended December 31, 2011.

As of December 31, 2011, there was a \$467.1 million balance of term loans outstanding under our Credit Facility and Notes. In addition, as of December 31, 2011, we had no outstanding borrowings under our current revolving line of credit, including the revolving credit facility under our senior credit facility and lines of credit in various foreign countries that are used to facilitate local short-term operating needs, except that \$12.9 million of the revolving credit facility is committed for letters of credit, leaving an aggregate of \$17.1 million available for additional borrowings under this revolving line of credit. We had cash and cash equivalents of \$43.6 million at December 31, 2011 compared to \$38.7 million at December 31, 2010. At December 31, 2010 we also had \$13.7 million of restricted cash which was classified as a current asset. The restricted cash served as collateral for letters of credit and was held in custody by the issuing bank.

Capital Expenditures

We use the term “capital expenditures” to refer to costs incurred to purchase or significantly upgrade property and equipment. The majority of our capital expenditures relate to purchases of machinery and equipment used in the manufacturing of our products. Capital expenditures were funded from net cash provided by operating activities and borrowings under our credit facility.

During 2011, we had capital expenditures of \$30.2 million consisting of growth capital expenditures of \$12.2 million and maintenance capital expenditures of \$18.0 million. Growth capital expenditures consist of items that are intended to increase the manufacturing, production and/or distribution capacity or efficiencies of our operations in conjunction with the execution of our business strategies. Maintenance capital expenditures are designed to sustain the current capacity or efficiency of our operations and include items relating to the renovation of existing manufacturing or service facilities, the purchase of machinery and equipment for safety and environmental needs and information technology.

During 2010, we had capital expenditures of \$27.9 million consisting of approximately \$15.3 million of growth capital expenditures and approximately \$12.6 million of maintenance capital expenditures.

During 2009, we had capital expenditures of \$19.5 million consisting of approximately \$10.6 million of growth capital expenditures and approximately \$8.9 million of maintenance capital expenditures.

We currently estimate capital expenditure levels for 2012 to be approximately \$30 million. We analyze our planned capital expenditures based on investment opportunities available to us and our financial and operating performance, and accordingly, actual capital expenditures may be more or less than these amounts.

See "Credit Facility and Notes" below for a description on limitations on capital expenditures imposed by our credit facility.

Credit Facility and Notes

On May 26, 2011, we completed a refinancing transaction, which replaced our Prior Credit Facility and Exit Facility with an offering of \$240 million aggregate principal amount of 8.875% senior unsecured notes (the "Notes") and a new approximately \$278 million multi-currency senior secured credit facility (the "Credit Facility"), comprised of approximately \$248 million of senior secured term loans and a committed \$30 million senior secured revolving credit facility. The interest rates under the Credit Facility are calculated, at our option, as the Alternate Base Rate as defined in the Credit Facility, LIBOR or EURIBOR, subject to a minimum of 2.25%, 1.25% and 1.25%, respectively, plus, in each case, a margin.

Notes

Interest on the Notes is payable semiannually in cash in arrears on June 15 and December 15 of each year and commenced on December 15, 2011. The Notes are senior unsecured obligations and are guaranteed by each of our direct and indirect wholly-owned domestic subsidiaries. They rank equal in right of payment with our existing and future senior indebtedness and senior in right of payment to any of our existing and future subordinated indebtedness. The Notes are effectively subordinated to all of our secured debt, including the Credit Facility and related guarantees, to the extent of the value of the assets securing such debt and structurally subordinated to all of the existing and future liabilities of our subsidiaries that do not guarantee the Notes. Subject to the terms of the Credit Facility, the Notes may be redeemed by us at specified redemption prices which vary depending on the timing of the redemption.

The Notes contain covenants, subject to certain exceptions, that restrict our ability and the ability of certain of our subsidiaries to, among other things:

- incur or guarantee additional indebtedness or issue preferred stock;
- pay dividends or make other distributions to stockholders;
- purchase or redeem capital stock or subordinated indebtedness;
- make certain investments;
- create liens;

- incur restrictions on the ability of our subsidiaries to make dividends or make other payments to us;
- sell assets or engage in sale-leaseback transactions;
- consolidate or merge with or into other companies or transfer all or substantially all of our assets; and
- engage in certain transactions with affiliates.

Credit Facility

The Credit Facility provides for:

- a six-year \$125.0 million senior secured term loan facility, borrowed by us, the proceeds of which were used to refinance certain of our existing indebtedness.
- a six-year €87.0 million senior secured term loan facility, borrowed by Xerium Technologies Limited, a wholly-owned indirect subsidiary of ours organized under the laws of England and Wales, the proceeds of which were used to refinance certain of our existing indebtedness.
- a five-year \$30.0 million senior secured revolving credit facility, available to us, and an uncommitted incremental amount of \$10 million, the proceeds of which will be used for working capital and general corporate purposes and include sub-limits available for letters of credit (the “Revolving Facility”); and
- an uncommitted incremental credit facility (the “Incremental Facility”) allowing for increases under the Revolving Facility and Term Loans with the same terms, and borrowing of new tranches of term loans, up to an aggregate principal amount not to exceed the greater of (i) \$100.0 million and (ii) our Adjusted EBITDA over the prior 12-month period, provided that increases under the Revolving Facility shall not exceed \$35.0 million.

The loans under the Credit Facility are required to be permanently repaid with 100% of the net proceeds of assets sales, dispositions, issuances of certain debt obligations and insurance, in each case, subject to certain exceptions and 50% of annual excess cash flow.

The Credit Facility requires us to make annual principal payments (payable in quarterly installments) equal to 1% per annum with respect to the Term Loans with the remaining amount due at final maturity.

The obligations under the Credit Facility are guaranteed by all of our existing and future direct and indirect subsidiaries that are organized in the United States (subject to certain exceptions in the case of immaterial subsidiaries and joint ventures) and certain of our direct and indirect foreign subsidiaries, provided that non-U.S. guarantors are only liable for obligations of Xerium Technologies Limited and certain other non-U.S. guarantors. The loans are secured by a first-priority perfected security interest in substantially all of the assets.

The Credit Facility contains customary covenants that, subject to certain exceptions, restrict our ability to, among other things:

- pay dividends or redeem or repurchase equity interests;
- prepay, redeem or purchase debt, including the Notes;
- create liens and engage in sale-leaseback transactions;
- make loans and investments;
- incur additional indebtedness;
- amend or otherwise alter debt and other material agreements;
- make capital expenditures;

- engage in mergers, acquisitions and asset sales (other than certain permitted acquisitions and asset sales);
- engage in certain transactions with affiliates; and
- engage in businesses that are not related to our existing business.

The Credit Facility includes specified financial covenants, requiring us to maintain certain consolidated leverage and interest coverage ratios. In addition, the terms of the Credit Facility limit our ability to make capital expenditures in excess of specified amounts.

The consolidated leverage ratio is calculated by dividing our total gross debt, at average currency exchange rates for the last twelve months, by Adjusted EBITDA and is 4.43 to 1.00 at December 31, 2011. In order to be in compliance with this covenant, we must have a ratio of no more than 5.50 to 1.00 from September 30, 2011 to March 31, 2012. In various periods subsequent to March 31, 2012, this ratio decreases by increments of 25 basis points to 3.25 to 1.00 for the quarter ended March 31, 2017.

The interest coverage ratio is calculated by dividing Adjusted EBITDA by interest expense, net of mark to market movements on hedging instruments and amortization of deferred financing costs, and is 2.92 to 1.00 at December 31, 2011. In order to be in compliance with this covenant, we must have a ratio of at least 2.25 to 1.00 from September 30, 2011 to December 31, 2012. In various periods subsequent to December 31, 2012, this ratio increases by increments of 25 basis points to 3.25 to 1.00 for the quarter ended March 31, 2017.

Each of these covenants is calculated at the end of each quarter and is based on a rolling twelve month period. At December 31, 2011 we were in compliance with these covenants, and we expect to remain in compliance with these covenants in the near future.

Contractual Obligations and Commercial Commitments

The following tables provide aggregated information about our contractual obligations as of December 31, 2011.

Contractual Obligations (in millions)	Payments Due by Period					
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years	Other
			(in millions)			
Long-term debt obligations	\$469.1	\$ 3.6	\$ 5.5	\$ 4.8	\$455.2	\$—
Interest expense on long-term debt (1)	207.9	34.5	68.5	68.0	36.9	—
Operating leases	24.2	5.3	8.0	5.8	5.1	—
Purchase obligations (2)	28.3	17.8	8.0	2.2	0.3	—
Pension and other postretirement obligations	79.6	6.8	13.3	14.8	44.7	—
Net unrecognized tax benefit obligation under Topic 740 (3)	8.6	0.1	0.9	—	—	7.6
Total contractual cash obligations	<u>\$817.7</u>	<u>\$68.1</u>	<u>\$104.2</u>	<u>\$95.6</u>	<u>\$542.2</u>	<u>\$ 7.6</u>

- (1) Interest expense shown above is based on the effective interest rate at December 31, 2011.
- (2) Includes obligations with respect to raw material purchases, repairs and maintenance services, utilities and capital expenditures.
- (3) The amounts in "Other" represent future cash outlays for which we are unable to reasonably estimate the period of cash settlement.

On December 9, 2011, the Company entered into an amendment to the employment agreement with Stephen R. Light, our Chairman, President and CEO, to promote continuity during a period of succession leading to Mr. Light's anticipated retirement. The amendment to Mr. Light's employment agreement provided that we would pay Mr. Light a \$2.2 million cash payment at the transition date, which is deemed to be December 31, 2012 at this time. This amount will be accrued throughout the remainder of his service with the Company.

Off-Balance Sheet Financing

During the year ended December 31, 2011, we did not engage in material off-balance sheet activities, including the use of structured finance or special purpose entities.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of net sales and expenses. Actual results could differ from those estimates. We have formal accounting policies in place including those that address critical and complex accounting areas. Note 2 to the consolidated financial statements included elsewhere in this Annual Report identifies the significant accounting policies used in preparation of the consolidated financial statements. The most significant areas involving management judgments and estimates are described below.

Derivatives and Hedging. Effective January 1, 2009, we adopted ASC Topic 815-10-65-1, *Transition and Effective Date Related to FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133* (“Topic 815-10-65-1”) for disclosure related to derivatives and hedging. Topic 815-10-65-1 amends and expands the disclosure requirements to provide users of financial statements with an enhanced understanding of: (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. Topic 815-10-65-1 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about the fair value of and gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative instruments.

As required by ASC Topic 815-10-65-1, we record all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether we have elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability or firm commitment attributable to a particular risk are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. We may enter into derivative contracts that are intended to economically hedge certain of our risks, even though hedge accounting does not apply or if we elect not to apply hedge accounting under Topic 815.

There are two types of hedges into which we may enter: hedges of fair value exposure and hedges of cash flow exposure. Hedges of fair value exposure are entered into in order to hedge the fair value of a recognized asset or liability, or a firm commitment. Hedges of cash flow exposure are entered into in order to hedge a forecasted transaction or the variability of cash flows to be paid related to a recognized liability. Changes in derivative fair values are recognized in earnings as offsets to the changes in fair value of the related hedged assets and liabilities. Changes in the derivative fair values that are designated as cash flow hedges which meet the criteria for hedge accounting are recorded in other comprehensive income (loss).

Prior to September 1, 2009, the effective portion of changes in the fair value of derivatives designated and that qualified as cash flow hedges were recorded in accumulated other comprehensive income (loss) and subsequently reclassified into earnings in the period that the hedged forecasted transaction affected earnings. The

ineffective portion of the change in fair value of the derivatives was recognized directly in earnings. The balance in accumulated other comprehensive loss as of August 31, 2009 related to the interest rate swaps for which hedge accounting was discontinued was subsequently reclassified into the statement of operations (interest expense) over the remaining original term of the derivative as the hedged forecasted transactions are also recorded to interest expense, in accordance with Topic 815. In addition, as of March 31, 2010, we determined that it was probable that future interest payments on the debt that was in excess of the \$410 million (discussed in Note 1 of the Notes to Consolidated Financial Statements) would not occur. As a result, we reclassified an additional \$0.7 million from accumulated other comprehensive income to interest expense, which represented the balance in accumulated other comprehensive income relating to interest payments on the debt that was in excess of \$410 million. As of March 31, 2010, after this reclassification, the remaining balance in accumulated other comprehensive loss related to interest rate swaps was amortized to interest expense through December 31, 2010, the original term of the swaps. Accordingly, during 2010, we amortized approximately \$9.7 million from accumulated other comprehensive income to interest expense.

On December 31, 2009, we terminated with the counterparties all of our outstanding interest rate swap liabilities of \$20.0 million and converted them into notes payable to such counterparties. Although these interest rate swaps were subject to mark to market accounting through earnings effective September 1, 2009, prior to their termination with the counterparties, they effectively fixed, from a cash flow hedge perspective through December 31, 2009, the interest rate at 10.75% on approximately 79% of the term loan portion of our pre-petition credit facility. As a result of the termination of the interest rate swaps, the interest rate on the term loan portion of the credit facility was no longer effectively fixed through December 31, 2010, the original term of the swaps.

We have measured our derivative assets and liabilities under ASC Topic 820, *Fair Value Measurements and Disclosures* ("Topic 820"), and have classified our interest rate swaps in Level 2 of the Topic 820 fair value hierarchy, as the significant inputs to the overall valuations are based on market-observable data or information derived from or corroborated by market-observable data, including market-based inputs to models, model calibration to market-clearing transactions, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. Where models are used, the selection of a particular model to value a derivative depends upon the contractual terms of, and specific risks inherent in, the instrument as well as the availability of pricing information in the market. We use similar models to value similar instruments. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, and correlations of such inputs. For our derivatives, all of which traded in liquid markets, model inputs can generally be verified and model selection does not involve significant management judgment.

To comply with the provisions of Topic 820, we performed a review of the necessity to incorporate credit valuation adjustments to appropriately reflect both our own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements of our derivatives, and determined these adjustments to be immaterial to the fair value derivative assets/(liabilities) recorded on our consolidated balance sheet at December 31, 2011.

As of December 31, 2010, the credit valuation adjustments have had no impact on the overall valuation of our derivative positions as we terminated all of our outstanding interest rate swaps with the counterparties on December 31, 2009. Various factors which impact changes in the credit are not significant to the overall valuation adjustments over time, including changes in the credit spreads of the parties to the contracts, as well as changes in market rates and volatilities, which affect the total expected exposure of the derivative instruments.

Although we have determined that the majority of the inputs used to value our derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with our derivatives utilize estimates of current credit spreads to evaluate the likelihood of default by us and our counterparties. As a result, we have determined that our derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy. We do not have any fair value measurements using significant unobservable inputs (Level 3) as of December 31, 2011.

On August 8, 2011, we entered into two interest rate cap agreements with certain financial institutions, with notional amounts totaling \$114.4 million, which limit our variable interest rate exposure to the strike rate of the interest rate cap agreements. Under the terms of the interest rate cap agreements, we will receive payments based on the spread in rates if the three-month LIBOR rate increases above the negotiated cap rates of 3.0%. The interest rate caps are considered designated hedging instruments, and classified as Level 2 in the fair value hierarchy. Changes in fair value will be deferred in other comprehensive income and the cap purchase price will be reclassified from other comprehensive income into earnings as interest expense over the life of the agreements.

Goodwill. We account for acquired goodwill and intangible assets in accordance with ASC Topic 805, *Business Combinations* ("Topic 805"). Purchase accounting required by Topic 805 involves judgment with respect to the valuation of the acquired assets and liabilities in order to determine the amount of goodwill. We have recorded our acquisitions in accordance with Topic 805.

Impairment of Goodwill and Indefinite-Lived Intangible Assets. We account for acquired goodwill and goodwill impairment in accordance with Topic 350, which requires considerable judgment in the valuation of acquired goodwill and the ongoing evaluation of goodwill impairment. Topic 350 requires that goodwill and intangible assets that have indefinite lives not be amortized but, instead, must be tested at least annually for impairment or whenever events or business conditions warrant.

We perform annual tests for goodwill impairment at the reporting unit level, which are clothing and roll covers. When our business was acquired in 1999, more than 80% of the goodwill was assigned to the roll covers reporting unit based on relative fair values at the date of acquisition.

Goodwill impairment testing is a two-step process. Step 1 involves comparing the fair value of our reporting unit to its carrying amount. If the fair value of the reporting unit is greater than its carrying amount, there is no impairment. If the reporting unit carrying amount is greater than the fair value then the second step must be completed to measure the amount of impairment, if any. Step 2 calculates the implied fair value of goodwill by deducting the fair value of the net assets of the reporting unit from the fair value of the reporting unit as determined in Step 1. The implied fair value of goodwill determined in this step is compared to the carrying value of goodwill. If the implied fair value of goodwill is less than the carrying value of goodwill, an impairment loss is recognized equal to the difference.

For the purpose of performing the annual impairment test, we allocate all shared assets and liabilities to the reporting units based upon the percentage of each reporting unit's revenue to total revenue. Shared expenses are allocated to each reporting unit to the extent necessary to allow them to operate as independent businesses. Fair value was determined by using a weighted combination of both a market multiple approach and an income approach. The market multiple approach utilizes our and our competitors' information to determine measures that are used to value our reporting units. The income approach is a present value technique used to measure the fair value of future cash flows produced by each reporting unit. Determining the fair value of a reporting unit or an indefinite-lived purchased intangible asset is judgmental in nature and requires the use of significant estimates and assumptions, including revenue growth rates and operating margins, discount rates and future market conditions, among others. We believe that the assumptions and rates used in our annual impairment test under Topic 350 are reasonable, but inherently uncertain.

Based on the assessments performed as of December 31, 2011, we determined that no impairment of goodwill exists. The excess of the fair value over carrying value for our clothing and roll covers segment as of December 31, 2011, the annual test date, was approximately \$120.6 million and \$109.3 million, respectively. In order to evaluate the sensitivity of the analysis performed, we applied a hypothetical 5% decrease to the fair value of the business segments, which resulted in a fair value in excess of carrying value of approximately \$98.2 million and \$97.0 million for the clothing segment and the roll covers segment, respectively.

Contingencies. We are subject to various claims and contingencies associated with lawsuits, insurance, tax, environmental and other issues arising out of the normal course of business. Our consolidated financial statements reflect the treatment of claims and contingencies based on management's view of the expected outcome. We consult with legal counsel on those issues related to litigation with respect to matters in the ordinary course of business. If the likelihood of an adverse outcome is probable and the amount is estimable, we accrue a liability in accordance with ASC Topic 450, *Contingencies*. While we believe that the current level of reserves is adequate, the adequacy of these reserves may change in the future due to new developments in particular matters. For example, during the third quarter of 2008, while evaluating our facility in Australia, we discovered the possibility of contamination at the facility. Subsequently we had a preliminary evaluation performed, which confirmed the existence of contamination and estimated preliminary costs to remediate this facility. Based upon this evaluation, we accrued \$4.1 million in 2008 as our best estimate of the remediation costs we expected to incur. A Phase II assessment of the groundwater contamination performed for us during the second quarter of 2009 indicated the costs to remediate the contamination would be significantly less than originally estimated and accordingly, we reduced the accrual by \$3.4 million during the second quarter of 2009 based on this assessment. At the end of the second quarter of 2010, we entered into a contingent purchase and sale agreement with a third party. Under the terms of the purchase and sale agreement, the environmental liability transferred to the third party at the time of such purchase, which occurred in the third quarter of 2011.

Income Taxes. We utilize the asset and liability method for accounting for income taxes in accordance with ASC Topic 740, *Income Taxes* ("Topic 740"). Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using the enacted tax rates and statutes that will be in effect when the differences are expected to reverse.

We record net deferred tax assets to the extent we believe that it is more likely than not that these assets will be realized. In making such determination, we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent results of operations. We reduce our deferred tax assets by a valuation allowance if, based upon the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. In light of our accumulated loss position in certain tax jurisdictions, and the uncertainty of taxability in future periods, we recorded a valuation allowance against all U.S. deferred tax assets and against certain of our foreign deferred tax assets primarily related to net operating loss carry-forwards in Australia, Canada, Germany, Sweden, the United Kingdom and France.

In addition, we operate within multiple taxing jurisdictions and could be subject to audit in these jurisdictions. These audits can involve complex issues and rely on estimates and assumptions. These audits may require an extended period of time to resolve and may cover multiple years. We adopted the uncertain tax provisions of Topic 740 on January 1, 2007. ASC Topic 740-10-25 relates to uncertain tax positions and prescribes a two-step process to determine the amount of tax benefit to be recognized as it relates to uncertain tax positions. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed "more-likely-than-not" to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of the benefit that may be recognized is the largest amount that has a greater than 50% likelihood of being realized upon ultimate settlement with the taxing authority having full knowledge of all relevant information.

We accrue for certain known and reasonably anticipated income tax obligations after assessing the likely outcome. Although we believe that the estimates and assumptions are reasonable, the final determination of tax audits and any related litigation could be different than that which is reflected in historical income tax provisions and recorded assets and liabilities. For example, during the fourth quarter of 2011, Xerium Technologies Brasil Indústria e Comércio S.A., a Brazilian indirect subsidiary, received a notice of proposed income tax assessment from the Federal Revenue Department of the Ministry of Finance of Brazil totaling approximately \$42.6 million (subject to currency exchange rates). Although there can be no assurances, we believe at the time of this filing, that it is more likely than not that we will prevail on every tax position under examination and therefore we have not accrued any amounts related to this assessment.

With respect to all jurisdictions, we believe we have made adequate provision for all income tax uncertainties.

We have a net deferred tax liability of \$9.5 million at December 31, 2011 and \$7.6 million at December 31, 2010. The net deferred tax liability relates principally to pension and post-retirement benefits, intangible assets and differences between the book and tax bases of property and equipment.

Our balance sheet as of December 2011 reflects a net deferred tax asset related to our German federal and trade loss carry-forwards of approximately \$2.5 million. As a general rule, federal and trade tax loss carry forwards are subject to forfeiture if more than 50% of the shares in the corporation are directly or indirectly transferred to a new shareholder. There is a restructuring exception to this general rule; however, effective December 2010, this exception has been suspended with retroactive effect. As of December 2011, we have continued to impair the portion of the deferred tax asset we believe to be subject to possible forfeiture.

Undistributed earnings of our foreign subsidiaries amounted to approximately \$173 million at December 31, 2011. These earnings are considered to be indefinitely reinvested for continued use in foreign operations except for Argentina, Brazil and Mexico. To the extent earnings are considered to be indefinitely reinvested, no provision for income taxes or withholding taxes has been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise we may be subject to both income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to the various jurisdictions. Determination of the amount of unrecognized deferred U.S. income tax liability or withholding taxes is not practicable because of the complexities associated with its hypothetical calculation; however, unrecognized foreign tax credit carry-forwards and net operating loss carry-forwards would be available to reduce some portion of the liability. Federal income taxes are provided on the portion of the income of foreign subsidiaries that is expected to be remitted to the United States and be taxable. We have not provided U.S. deferred taxes on cumulative earnings of foreign subsidiaries that we consider to be permanently reinvested. These earnings relate to on-going operations, and were approximately \$103.7 million as of December 31, 2011.

Non-GAAP Liquidity Measures

We use EBITDA and Adjusted EBITDA (as defined in the Credit Facility) as supplementary non-GAAP liquidity measures to assist us in evaluating our liquidity and financial performance, specifically our ability to service indebtedness and to fund ongoing capital expenditures. The Credit Facility includes covenants based on Adjusted EBITDA. If our Adjusted EBITDA declines below certain levels, we may violate the covenants resulting in a default condition under the credit facility or be required to prepay the credit facility. Neither EBITDA nor Adjusted EBITDA should be considered in isolation or as a substitute for income (loss) from operations (as determined in accordance with GAAP). See “Credit Facility and Notes” for discussion of the covenants for the Credit facility.

Adjusted EBITDA for the year ended December 31, 2011 is presented based on the Credit Facility. However, Adjusted EBITDA for the year ended December 31, 2010 is presented based on the Prior Credit Facility. Financial restructuring costs are not adjustments under the definition of Adjusted EBITDA in the Credit Facility to arrive at Adjusted EBITDA for periods beginning after the quarter ended June 30, 2011. For the year ended December 31, 2010, as applicable, such items were added back to Adjusted EBITDA based upon the terms of the Prior Credit Facility. Had these adjustments not been in place in 2010, Adjusted EBITDA would have decreased by \$26.2 million.

EBITDA is defined as net income (loss) before interest expense, income tax provision (benefit) and depreciation (including non-cash impairment charges) and amortization.

“Adjusted EBITDA”, under the Credit Facility means, with respect to any period, the total of (A) the consolidated net income for such period, plus (B) without duplication, to the extent that any of the following were deducted in computing such consolidated net income for such period: (i) provision for taxes based on income or profits, including, without limitation, federal, state, provincial, franchise and similar taxes, including

any penalties and interest relating to any tax examinations, (ii) consolidated interest expense, (iii) consolidated depreciation and amortization expense, (iv) reserves for inventory in connection with plant closures, (v) consolidated operational restructuring costs, (vi) noncash charges or gains resulting from the application of purchase accounting, including push-down accounting, (vii) non-cash expenses resulting from the granting of common stock, stock options, restricted stock or restricted stock unit awards under equity compensation programs solely with respect to common stock, and cash expenses for compensation mandatorily applied to purchase common stock, (viii) non-cash items relating to a change in or adoption of accounting policies, (ix) non-cash expenses relating to pension or benefit arrangements, (x) expenses incurred as a result of the repurchase, redemption or retention of common stock earned under equity compensation programs solely in order to make withholding tax payments, (xi) amortization or write-offs of deferred financing costs, (xii) any non-cash losses resulting from mark to market hedging obligations (to the extent the cash impact resulting from such loss has not been realized in such period) and (xiii) other non-cash losses or charges (excluding, however, any non-cash loss or charge which represents an accrual of, or a reserve for, a cash disbursement in a future period), minus (C) without duplication, to the extent any of the following were included in computing consolidated net income for such period, (i) non-cash gains with respect to the items described in clauses (vi), (vii), (ix), (xi), (xii) and (xiii) (other than, in the case of clause (xiii), any such gain to the extent that it represents a reversal of an accrual of, or reserve for, a cash disbursement in a future period) of clause (B) above and (ii) provisions for tax benefits based on income or profits. Notwithstanding the foregoing, Adjusted EBITDA, as defined in the Credit Facility and calculated below, may not be comparable to similarly titled measurements used by other companies.

Consolidated net income is defined as net income (loss) determined on a consolidated basis in accordance with GAAP; provided, however, that the following, without duplication, shall be excluded in determining consolidated net income: (i) any net after-tax extraordinary or non-recurring gains, losses or expenses (less all fees and expenses relating thereto), (ii) the cumulative effect of changes in accounting principles, (iii) any fees and expenses incurred during such period in connection with the issuance or repayment of indebtedness, any refinancing transaction or amendment or modification of any debt instrument, in each case, as permitted under the Credit Facility and (iv) any gains resulting from the returned surplus assets of any pension plan.

The following table provides reconciliation from net income (loss) and operating cash flows, which are the most directly comparable GAAP financial measures, to EBITDA and Adjusted EBITDA.

	Year ended December 31,		
	2011	2010	2009
	(in thousands)		
Net income (loss)	\$ 8,190	\$ (73,086)	\$(111,993)
Goodwill impairment	—	—	80,600
Stock-based compensation	1,439	7,310	2,305
Depreciation	41,381	38,963	39,539
Amortization of intangibles	2,305	2,318	2,328
Curtailment/settlement gain	402	—	—
Deferred financing cost amortization	2,307	5,953	5,417
Unrealized foreign exchange loss (gain) on revaluation of debt	139	(1,621)	(1,626)
Deferred taxes	334	8,614	7,586
(Gain) on disposition of property and equipment	(564)	(2,105)	(1,979)
Asset impairment	—	2,890	1,669
Non-cash interest expense related to interest rate swaps	—	9,721	3,818
Loss on extinguishment of debt	2,926	—	—
Non-cash reorganization items	—	28,683	—
Reorganization expenses accrued	—	115	—
Net change in operating assets and liabilities	(13,651)	(7,021)	(11,533)
Net cash provided by operating activities	45,208	20,734	16,131
Interest expense, excluding amortization	36,843	41,121	58,065
Net change in operating assets and liabilities	13,653	7,021	11,533
Current portion of income tax expense	10,343	9,652	4,731
Goodwill impairment	—	—	(80,600)
Stock-based compensation	(1,439)	(7,310)	(2,305)
Curtailment/settlement gain	(402)	—	—
Asset impairment	—	(2,890)	(1,669)
Unrealized foreign exchange gain (loss) on revaluation of debt	(139)	1,621	1,626
Gain (loss) on disposition of property and equipment	564	2,105	1,979
Non-cash reorganization items	—	(28,798)	—
Loss on extinguishment of debt	(2,926)	—	—
EBITDA	101,705	43,256	9,491
Financial restructuring costs (1)	—	26,197	—
Write-off of deferred financing costs (2)	2,926	14,283	—
Expenses incurred in connection with indebtedness or refinancing transaction	—	14,400	—
Non-cash compensation and related expenses	1,439	7,310	2,305
Operational restructuring expenses	1,589	7,114	2,411
Non-cash impairment charges	—	2,890	82,269
Inventory write-offs under restructuring programs	—	—	349
Change in fair value of interest rate swaps	—	—	(3,818)
Non-cash change in accounting estimates	—	(1,400)	—
Adjusted EBITDA	\$107,659	\$114,050	\$ 93,007

- (1) Financial restructuring costs are not adjustments under the definition of Adjusted EBITDA in the Credit Facility to arrive at Adjusted EBITDA for periods beginning after the quarter ended June 30, 2011. For the year ended December 31, 2010, as applicable, such items were added back to Adjusted EBITDA based upon the terms of the Prior Credit Facility. Had these adjustments not been in place in 2010, Adjusted EBITDA would have decreased by \$26.2 million.
- (2) In the year ended December 31, 2010, the \$14.3 million was included in reorganization expenses in the Condensed Consolidated Statement of Operations.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The effects of potential changes in interest rates and foreign currency rates are discussed below. Our market risk discussion includes “forward-looking statements” and represents an estimate of possible changes in fair value or future earnings that would occur assuming hypothetical future movements in interest rates and foreign currency rates. Actual future results may differ materially from those presented. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources” and the Notes to Consolidated Financial Statements for a description of our accounting policies and other information related to these financial instruments.

Foreign Currency Hedging

We have foreign currency cash flow and earnings exposure with respect to specific sale and intercompany debt transactions denominated in currencies other than the functional currency of the unit incurring the costs associated with such transactions. To mitigate the risks related to these exposures, we utilize forward currency contracts in certain circumstances, to lock in exchange rates with the objective that the gain or loss on the forward contracts will approximate the loss or gain on the transaction or transactions being hedged. We determine whether to enter into hedging arrangements based upon the size of the underlying transaction or transactions, an assessment of the risk of adverse movements in the applicable currencies and the availability of a cost-effective hedging strategy. In South America, substantially all of our net sales are indexed to U.S. Dollars, but the associated costs are recorded in the local currencies of the operating units. Generally, we do not hedge this U.S. Dollar exposure as it would not be cost effective due to the relatively inefficient foreign exchange markets for local currencies in that region. To the extent we do not engage in hedging or such hedging is not effective, changes in the relative value of currencies can affect our profitability.

The value of these contracts is recognized at fair value based on market exchange forward rates and amounted to a net asset position of \$123 at December 31, 2011. These contracts mature at various dates through June of 2012.

As of December 31, 2011, we had open foreign currency exchange contracts maturing through June of 2012 with total net notional amounts of approximately \$32.6 million. At December 31, 2011, a hypothetical adverse exchange rate movement of 10% against our forward foreign exchange contracts would have resulted in a potential net loss in fair value of these contracts of approximately \$3.3 million. The calculation assumes that each exchange rate would change in the same direction relative to the U.S. Dollar. Any gain or loss recognized on a foreign exchange contract would generally be offset by the gain or loss on the underlying hedge transaction. In addition to the direct effects of changes in exchange rates, such changes may affect the volume of sales or the foreign currency sales price as competitors’ products become more or less attractive. Our sensitivity analysis of the effects of changes in foreign currency exchange rates does not factor in a potential change in sales levels or local currency selling prices.

For additional information about the risks associated with fluctuations in currency exchange rates, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Foreign Exchange.”

Interest Rate Hedging

We borrow funds at a combination of fixed and variable rates. Our debt consists of a secured credit facility with variable interest rates and unsecured notes which bear interest at fixed rates. Our interest rate risk management objectives are to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs. To achieve these objectives, from time to time we enter into interest rate hedge contracts such as swaps and caps in order to mitigate our interest rate risk with respect to various debt instruments. We generally do not hold or issue these derivative contracts for trading or speculative purposes.

At December 31, 2011, we had \$227.1 million of variable rate debt outstanding of which \$105.5 million is protected by interest rate caps (see Note 8 to the Consolidated Financial Statements for further discussion on our interest rate caps). If the weighted average interest rates on this variable rate debt had been 100 basis points higher, the annual interest expense would have increased by \$1.5 million.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

All financial statements required to be filed under this Item 8, other than selected quarterly financial data, are filed as Appendix A hereto, are listed under Item 15(a) and are incorporated herein by this reference.

Selected quarterly financial data are included under Item 6 and are incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As of December 31, 2011, under the supervision of our principal executive officer and principal financial officer, and with the participation of our management, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based upon that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms; and (ii) accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosures. No evaluation of disclosure controls and procedures can provide absolute assurance that these controls and procedures will operate effectively under all circumstances. However, our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives, and our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures are effective at the reasonable assurance level as set forth above.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Our management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2011. In making its assessment, management has utilized the criteria set forth by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission in *Internal Control—Integrated Framework*. Our management concluded that based on its assessment, our internal control over financial reporting was effective as

of December 31, 2011. Ernst & Young LLP, our independent registered public accounting firm, has issued its report on the effectiveness of internal control over financial reporting as of December 31, 2011, which appears in this 2011 Form 10-K.

There has been no change in our internal control over financial reporting during the quarter ended December 31, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Xerium Technologies, Inc.

We have audited Xerium Technologies, Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO Criteria). Xerium Technologies, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Xerium Technologies, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Xerium Technologies, Inc. as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2011, and our report dated March 14, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Raleigh, North Carolina
March 14, 2012

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item is incorporated by reference to our Proxy Statement for the 2012 Annual Meeting of Shareholders.

In July of 2011 we filed with the NYSE the Annual CEO Certification regarding our compliance with the NYSE's Corporate Governance listing standards as required by Section 303A-12(a) of the NYSE Listed Company Manual. In addition, we filed as exhibits to this Annual Report on Form 10-K the applicable certifications of our Chief Executive Officer and Chief Financial Officer required under Section 302 of the Sarbanes-Oxley Act of 2002, regarding the quality of our public disclosures.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated by reference to our Proxy Statement for the 2012 Annual Meeting of Shareholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is incorporated by reference to our Proxy Statement for the 2012 Annual Meeting of Shareholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item is incorporated by reference to our Proxy Statement for the 2012 Annual Meeting of Shareholders.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this item is incorporated by reference to our Proxy Statement for the 2012 Annual Meeting of Shareholders.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) (1) Financial Statements. The following documents are filed as Appendix A hereto and are included as part of this Annual Report on Form 10-K:

Financial Statements of Xerium Technologies, Inc.:

Report of Independent Registered Public Accounting Firm on the Consolidated Financial Statements and Schedule

Consolidated Balance Sheets as of December 31, 2011 and 2010

Consolidated Statements of Operations for the years ended December 31, 2011, 2010 and 2009

Consolidated Statements of Stockholders' (Deficit) Equity for the years ended December 31, 2011, 2010 and 2009

Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009

Notes to Consolidated Financial Statements

(a) (2) Financial Statement Schedules. The following financial statement schedule is included as part of this Annual Report on Form 10-K:

Schedule II, Valuation and Qualifying Accounts

Certain schedules are omitted because they are not applicable, or not required, or because the required information is included in the financial statements or notes thereto.

(a) (3) Exhibits. The exhibits filed as part of this Annual Report on Form 10-K are listed in the Exhibit Index immediately preceding such exhibits, and are incorporated herein by this reference. We have identified with plus symbols in the Exhibit Index each management contract and compensation plan filed as an exhibit to this Annual Report on Form 10-K.

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in Raleigh, North Carolina, on March 14, 2012

XERIUM TECHNOLOGIES, INC.

By: /s/ STEPHEN R. LIGHT
Stephen R. Light
Chairman, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons in the capacities indicated on March 14, 2012.

<u>Signature</u>	<u>Title</u>
<u>/s/ STEPHEN R. LIGHT</u> Stephen R. Light	Chairman, President, Chief Executive Officer and Director (Principal Executive Officer)
<u>/s/ CLIFFORD E. PIETRAFITTA</u> Clifford E. Pietrafitta	Executive Vice President and CFO (Principal Financial and Accounting Officer)
<u>/s/ AMBASSADOR APRIL H. FOLEY</u> Ambassador April H. Foley	Director
<u>/s/ JAY GURANDIANO</u> Jay Gurandiano	Director
<u>/s/ JOHN F. MCGOVERN</u> John F. McGovern	Director
<u>/s/ DAVID A. BLOSS, SR.</u> David A. Bloss, Sr.	Director
<u>/s/ MARC SAIONTZ</u> Marc Saiontz	Director
<u>/s/ JAMES F. WILSON</u> James F. Wilson	Director

Index to Consolidated Financial Statements

XERIUM TECHNOLOGIES, INC.

CONSOLIDATED FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Xerium Technologies, Inc.

We have audited the accompanying consolidated balance sheets of Xerium Technologies, Inc. as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' (deficit) equity, and cash flows for each of the three years in the period ended December 31, 2011. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Xerium Technologies, Inc. at December 31, 2011 and 2010, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Xerium Technologies, Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 14, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Raleigh, North Carolina
March 14, 2012

XERIUM TECHNOLOGIES, INC.
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2011	2010
	(dollars in thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 43,566	\$ 38,701
Restricted cash	—	13,701
Accounts receivable, (net of allowance for doubtful accounts of \$5,232 in 2011 and \$4,755 in 2010)	91,784	93,332
Inventories	83,317	81,927
Prepaid expenses	6,177	5,108
Other current assets	15,051	16,113
Total current assets	239,895	248,882
Property and equipment, net	335,256	361,270
Goodwill	59,120	60,958
Intangible assets	22,640	12,958
Other assets	8,810	5,874
Total assets	\$ 665,721	\$ 689,942
LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY		
Current liabilities:		
Notes payable	\$ —	\$ 184
Accounts payable	39,743	41,686
Accrued expenses	47,805	48,207
Current maturities of long-term debt	3,548	12,794
Total current liabilities	91,096	102,871
Long-term debt, net of current maturities	465,506	468,383
Deferred and long-term taxes	18,582	17,775
Pension, other post-retirement and post-employment obligations	81,188	69,646
Other long-term liabilities	11,654	12,532
Commitments and contingencies (Note 12)		
Stockholders' (deficit) equity :		
Preferred stock, \$0.001 par value, 1,000,000 shares authorized; no shares outstanding as of December 31, 2011 and 2010	—	—
Common stock, \$0.001 par value, 20,000,000 shares authorized; 15,145,451 and 14,970,095 shares outstanding as of December 31, 2011 and 2010, respectively (1)	15	15
Stock warrants	13,532	13,560
Paid-in capital	411,498	411,531
Accumulated deficit	(395,804)	(403,994)
Accumulated other comprehensive loss	(31,546)	(2,377)
Total stockholders' (deficit) equity	(2,305)	18,735
Total liabilities and stockholders' (deficit) equity	\$ 665,721	\$ 689,942

(1) Reflects a 20-to-1 reverse stock split and change in par value from \$.01 to \$.001 that occurred on May 25, 2010.

See accompanying notes.

XERIUM TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended December 31,		
	2011	2010	2009
	(dollars in thousands except per share data)		
Net sales	\$ 586,960	\$ 548,334	\$ 500,091
Costs and expenses:			
Cost of products sold	370,754	333,958	312,596
Selling	79,407	72,883	66,808
General and administrative	62,012	74,798	56,169
Restructuring and impairments	1,589	10,004	4,080
Research and development	12,097	11,427	11,309
Goodwill impairment	—	—	80,600
	<u>525,859</u>	<u>503,070</u>	<u>531,562</u>
Income (loss) from operations	61,101	45,264	(31,471)
Interest expense	(39,531)	(57,912)	(68,480)
Interest income	381	1,117	1,180
Loss on extinguishment of debt	(2,926)	—	—
Foreign exchange (loss) gain	(156)	1,668	(905)
Income (loss) before reorganization expenses and provision for income taxes	18,869	(9,863)	(99,676)
Reorganization items	—	(44,957)	—
Income (loss) before provision for income taxes	18,869	(54,820)	(99,676)
Provision for income taxes	(10,679)	(18,266)	(12,317)
Net income (loss)	<u>\$ 8,190</u>	<u>\$ (73,086)</u>	<u>\$ (111,993)</u>
Net income (loss) per share:			
Basic (1)	<u>\$ 0.54</u>	<u>\$ (7.29)</u>	<u>\$ (45.80)</u>
Diluted (1)	<u>\$ 0.54</u>	<u>\$ (7.29)</u>	<u>\$ (45.80)</u>
Shares used in computing net income (loss) per share:			
Basic (1)	<u>15,079,771</u>	<u>10,019,098</u>	<u>2,445,381</u>
Diluted (1)	<u>15,083,835</u>	<u>10,019,098</u>	<u>2,445,381</u>

(1) Reflects a 20-to-1 reverse stock split and change in par value from \$.01 to \$.001 that occurred on May 25, 2010.

See accompanying notes.

XERIUM TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' (DEFICIT) EQUITY

	Common Stock		Warrants	Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity (Deficit)
	Shares	Amount					
				(dollars in thousands)			
Balance at December 31, 2008	2,312,889	\$ 2	\$ —	\$220,831	\$(218,915)	\$(29,499)	\$ (27,581)
Components of comprehensive income (loss):							
Net loss	—	—	—	—	(111,993)	—	(111,993)
Foreign currency translation adjustments	—	—	—	—	—	16,488	16,488
Change in funded status under Topic 715, net of income taxes of \$ (2,086)	—	—	—	—	—	(2,244)	(2,244)
Change in value of derivative instruments, net of income taxes of \$ 211	—	—	—	—	—	4,138	4,138
Total other comprehensive loss	—	—	—	—	—	—	(93,611)
Issuance of common stock	133,897	—	—	(770)	—	—	(770)
Compensation expense	—	—	—	2,305	—	—	2,305
Balance at December 31, 2009	2,446,786	2	—	222,366	(330,908)	(11,117)	(119,657)
Components of comprehensive income (loss):							
Net loss	—	—	—	—	(73,086)	—	(73,086)
Foreign currency translation adjustments	—	—	—	—	—	2,628	2,628
Change in funded status under Topic 715, net of income taxes of \$ (25)	—	—	—	—	—	(3,609)	(3,609)
Change in value of derivative instruments, net of income taxes of \$ 323	—	—	—	—	—	9,721	9,721
Total other comprehensive loss	—	—	—	—	—	—	(64,346)
Issuance of common stock	119,364	—	—	(326)	—	—	(326)
Cancellation of shares in connection with the reorganization	(2,566,150)	(2)	—	(865)	—	—	(867)
Issuance of common stock in connection with the reorganization	14,970,050	15	—	196,606	—	—	196,621
Reclassification of warrants	—	—	13,560	(13,560)	—	—	—
Issuance of common stock	45	—	—	—	—	—	—
Compensation expense	—	—	—	7,310	—	—	7,310
Balance at December 31, 2010	14,970,095	15	13,560	411,531	(403,994)	(2,377)	18,735
Components of comprehensive income (loss):							
Net income	—	—	—	—	8,190	—	8,190
Foreign currency translation adjustments	—	—	—	—	—	(14,850)	(14,850)
Change in funded status under Topic 715, net of income taxes of \$ (238)	—	—	—	—	—	(13,799)	(13,799)
Change in value of derivative instruments, net of income taxes of \$ 0	—	—	—	—	—	(520)	(520)
Total other comprehensive loss	—	—	—	—	—	—	(20,979)
Issuance of common stock	175,356	—	—	(1,472)	—	—	(1,472)
Redemption of warrants	—	—	(28)	—	—	—	(28)
Compensation expense	—	—	—	1,439	—	—	1,439
Balance at December 31, 2011	15,145,451	\$ 15	\$13,532	\$411,498	\$(395,804)	\$(31,546)	\$ (2,305)

(1) Reflects a 20-to-1 reverse stock split and change in par value from \$.01 to \$.001 that occurred on May 25, 2010.

See accompanying notes.

XERIUM TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,		
	2011	2010	2009
	(dollars in thousands)		
Operating activities			
Net income (loss)	\$ 8,190	\$ (73,086)	\$ (111,993)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Goodwill impairment	—	—	80,600
Stock-based compensation	1,439	7,310	2,305
Depreciation	41,381	38,963	39,539
Amortization of other intangibles	2,305	2,318	2,328
Deferred financing cost amortization	2,307	5,953	5,417
Unrealized foreign exchange gain (loss) on revaluation of debt	139	(1,621)	(1,626)
Deferred taxes	334	8,614	7,586
Asset impairments	—	2,890	1,669
Gain on disposition of property and equipment	(564)	(2,105)	(1,979)
Non-cash reorganization items	—	28,683	—
Reorganization expenses accrued	—	115	—
Change in the fair value of interest rate swaps	—	9,721	3,818
Curtailment/settlement loss	402	—	—
Loss on extinguishment of debt	2,926	—	—
Provision (credit) for doubtful accounts	1,255	(1,180)	(4,964)
Change in assets and liabilities which (used) provided cash:			
Accounts receivable	(870)	(9,648)	26,874
Inventories	(3,413)	(4,811)	12,726
Prepaid expenses	(305)	700	(682)
Other current assets	(1,172)	(2,074)	3,896
Accounts payable and accrued expenses	(3,820)	11,602	(48,986)
Deferred and other long-term liabilities	(5,326)	(1,610)	(397)
Net cash provided by operating activities	<u>45,208</u>	<u>20,734</u>	<u>16,131</u>
Investing activities			
Capital expenditures	(30,154)	(27,928)	(19,532)
Proceeds from disposals of property and equipment	7,764	4,170	4,261
Restricted cash	13,701	(13,701)	—
Other	1	(29)	1,100
Net cash used in investing activities	<u>(8,688)</u>	<u>(37,488)</u>	<u>(14,171)</u>
Financing activities			
Net decrease in borrowings (maturities of 90 days or less)	(181)	(1,025)	28,000
Proceeds from borrowings (maturities longer than 90 days)	489,810	402	163
Proceeds from debtor-in-possession financing facility to term loan	—	60,000	—
Principal payments on debt	(503,790)	(18,579)	(41,303)
Payment of deferred financing fees	(17,302)	(8,172)	—
Other	—	—	(1,490)
Net cash (used in) provided by financing activities	<u>(31,463)</u>	<u>32,626</u>	<u>(14,630)</u>
Effect of exchange rate changes on cash flows	(192)	(210)	976
Net increase (decrease) in cash	4,865	15,662	(11,694)
Cash and cash equivalents at beginning of year	38,701	23,039	34,733
Cash and cash equivalents at end of year	<u>\$ 43,566</u>	<u>\$ 38,701</u>	<u>\$ 23,039</u>
Interest payments	<u>\$ 35,302</u>	<u>\$ 41,419</u>	<u>\$ 59,246</u>
Income tax payments	<u>\$ 9,269</u>	<u>\$ 8,554</u>	<u>\$ 10,436</u>
Supplemental schedule of noncash activities:			
Issuance of common stock to extinguish debt	<u>\$ —</u>	<u>\$ 182,213</u>	<u>\$ —</u>
Conversion of debtor-in-possession financing facility to term loan	<u>\$ —</u>	<u>\$ 60,000</u>	<u>\$ —</u>
Cash reorganization items	<u>\$ —</u>	<u>\$ 16,159</u>	<u>\$ —</u>
Conversion of interest rate swaps into notes payable (Note 6)	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 20,036</u>

See accompanying notes.

XERIUM TECHNOLOGIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands except per share data)
December 31, 2011

1. Company Description

Xerium Technologies, Inc. (the “Company”) is a leading global manufacturer and supplier of two types of consumable products used primarily in the production of paper – clothing and roll covers. Its operations are strategically located in the major paper-making regions of the world, including North America, Europe, South America and Asia-Pacific.

Debt Refinancing

On May 26, 2011, the Company completed a refinancing transaction, which replaced certain of its then outstanding indebtedness with an offering of \$240 million of its 8.875% senior unsecured notes due 2018 (the “Notes”) and a new approximately \$278 million multi-currency senior secured credit facility (the “Credit Facility”), comprised of approximately \$248 million of senior secured term loans and a committed \$30 million senior secured revolving credit facility. The goal of the refinancing was to extend the maturity of, and fix the interest rate on, a portion of the Company’s debt, while providing increased operational flexibility. See Note 7 for a discussion of the Notes and Credit Facility.

Chapter 11 Filing, Emergence and Plan of Reorganization

On March 30, 2010 (the “Commencement Date”), the Company and certain of its subsidiaries (the “Debtor Subsidiaries”) filed voluntary petitions for relief under Chapter 11 of Title 11 of the United States Code, 11 U.S.C. §§ 101-1532 (as amended, the “Bankruptcy Code”), and on April 1, 2010, following approval by the Bankruptcy Court, the Company entered into a debtor-in-possession financing facility consisting of a \$20,000 revolving credit facility and \$60,000 term loan (the “DIP Facility” subsequently converted to the “Exit Facility”). On May 25, 2010 (the “Effective Date”), the Company’s amended joint prepackaged plan of reorganization (the “Plan”) became effective and the Company and the Debtor Subsidiaries emerged from Chapter 11. Pursuant to the Plan, on the Effective Date:

- 20 million shares of new common stock of the Company, par value \$0.001 (the “New Common Stock”) were authorized, of which an aggregate of 14,970,050 shares were issued and outstanding, as described below. In addition, 1,000,000 shares of preferred stock of the Company, par value \$0.001, were authorized, of which 20,000 shares are designated as Series A Junior Participating Preferred Stock;
- All of the shares of the Company’s common stock outstanding (the “Old Common Stock”), par value \$0.01, were canceled and replaced with 2,566,150 shares of New Common Stock, which was equivalent to a 20 to 1 reverse split of the Old Common Stock;
- The Company’s lenders under its pre-petition credit facility and its interest rate swap termination counterparties (collectively, the “Lenders”) received, among other things, their ratable shares of (a) \$10,000 in cash, (b) \$410,000 in principal amount of term notes, issued pursuant to the Company’s post-reorganization senior credit facility (“Prior Credit Facility”), and (c) 12,403,900 shares of New Common Stock; and
- Holders of the Company’s Old Common Stock also received four-year warrants to purchase an aggregate of 1,663,760 shares of New Common Stock (the “Warrants”) at an exercise price of \$19.55 per share, representing approximately 0.0324108 Warrants for each share of Old Common Stock.

XERIUM TECHNOLOGIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(dollars in thousands except per share data)
December 31, 2011

Accounting for Reorganization

Subsequent to the Commencement Date and through the Effective Date, the Company's financial statements were prepared in accordance with the Accounting Standards Codification ("ASC") Topic 852, *Reorganizations* ("Topic 852"). Topic 852 does not change the application of U.S. generally accepted accounting principles ("GAAP") in the preparation of the Company's financial statements. However, for periods including and subsequent to the filing of a Chapter 11 petition, Topic 852 does require that the financial statements distinguish transactions and events that are directly associated with the reorganization from those that are associated with the ongoing operations of the business. Because the reorganization value of the Company's assets was greater than the sum of its post-petition liabilities and allowed claims, the Company did not adopt the fresh-start reporting principles of Topic 852.

In accordance with Topic 852, the Company (i) separated liabilities that are subject to compromise from liabilities that are not subject to compromise, during the period subsequent to the Commencement Date and prior to the Effective Date; and (ii) distinguished transactions and events that were directly associated with the reorganization from those that are associated with the ongoing operations of the business.

Reorganization items are presented separately in the accompanying consolidated statement of operations and represent expenses that the Company identified as directly relating to the reorganization. These items for the year ended December 31, 2010 are summarized as follows:

	Year Ended December 31, 2010
Legal and professional fees	\$16,274
Loss on extinguishment of debt	14,400
Write-off of deferred financing costs on pre-petition credit facility	14,283
	<u>\$44,957</u>

Restricted Cash

At December 31, 2010 the Company had \$13.7 million of restricted cash, which was classified as a current asset. The restricted cash served as collateral for letters of credit. The cash was held in custody by the collateral agent, and was restricted as to withdrawal or use and had been invested in money market funds. Income from these funds was paid to the Company. Under the Credit Facility, there is no requirement for cash collateral for letters of credit; therefore, the Company has no restricted cash at December 31, 2011.

2. Accounting Policies

Basis of Presentation

The consolidated financial statements have been prepared on the basis of GAAP. The consolidated financial statements include the accounts of Xerium Technologies, Inc. and its wholly-owned subsidiaries. Intercompany accounts and transactions have been eliminated.

Revenue Recognition

Revenue on product sales is recognized when persuasive evidence of an arrangement exists, the price is fixed and determinable, delivery including transfer of title has occurred, and there is a reasonable assurance of collection of the sales proceeds. The Company generally obtains written purchase authorizations from customers

XERIUM TECHNOLOGIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(dollars in thousands except per share data)
December 31, 2011

for a specific product at a specified price and considers delivery and transfer of title to have occurred primarily at the time of shipment. Revenue is recorded net of applicable allowances, including estimated allowances for returns, rebates, and other discounts. In our clothing segment, a small portion of our business has been conducted pursuant to consignment arrangements under which the Company does not recognize a sale of a product to a customer until the customer places the product into use, which typically occurs some period after the product is shipped to the customer or to a warehouse location near the customer's facility. As part of the consignment agreement the Company delivers the goods to a location designated by the customer. In addition, the customer and the Company agree to a "sunset" date, which represents the date by which the customer must accept all risks and rewards of ownership of the product and payment terms begin. For consignment sales, revenue is recognized on the earlier of the actual product installation date or the "sunset" date.

Classification of Costs and Expenses

Cost of products sold includes raw materials, manufacturing labor, direct and indirect overhead costs, product freight, and depreciation of manufacturing plant and equipment. Warehousing costs incurred as a result of customer-specific delivery terms are also included in cost of products sold.

Selling expenses include direct sales force salaries, commissions and expenses as well as agents' commissions and fees, other warehousing costs, advertising costs and marketing costs.

General and administrative expenses include costs relating to management and administrative staff such as employee compensation and benefits, travel and entertainment, non-manufacturing facility occupancy costs including rent expense and professional fees, as well as depreciation on non-manufacturing equipment and office supplies and expenses.

Research and development expenses are comprised of engineering staff wages and associated fringe benefits, as well as the cost of prototypes, testing materials and non-capitalizable testing equipment.

Advertising Costs

Selling expenses include advertising expenses of \$1,380, \$1,108 and \$898 in 2011, 2010 and 2009, respectively. The Company expenses all advertising costs as incurred.

Translation of Financial Statements

The reporting currency of the Company is U.S. Dollars. Assets and liabilities of non-U.S. operations are translated at year-end rates of exchange, and the consolidated statements of operations and cash flows are translated at the average rates of exchange during the year. Gains and losses resulting from translating non-U.S. Dollar denominated financial statements are recorded in accumulated other comprehensive income (loss) as a component of stockholders' (deficit) equity.

Foreign Exchange

Foreign exchange gains and losses arising out of transactions denominated in currencies other than a subsidiary's functional currency are recorded in the consolidated statements of operations. Net exchange gains and losses are recorded in "Foreign exchange gain (loss)" and amounted to a loss of \$156 for the year ended

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December 31, 2011, a gain of \$1,668 for the year ended December 31, 2010 and a loss of \$905 for the year ended December 31, 2009. Certain intercompany loans have been determined to be permanent, and accordingly, foreign exchange gains or losses related to such loans are recorded in accumulated other comprehensive income (loss).

Derivatives and Hedging

Derivatives and Hedging

As required by ASC Topic 815, *Derivatives and Hedging* (“Topic 815”), the Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability or firm commitment attributable to a particular risk are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transaction in a cash flow hedge.

The Company may enter into derivative contracts that are intended to economically hedge certain of its risks, even though hedge accounting does not apply or the Company elects not to apply hedge accounting under Topic 815. See Note 8 for further discussion on the Company’s derivatives.

Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of net sales and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and highly liquid short-term investments with maturities of three months or less when acquired. Short-term investments consist of time deposits or money market accounts at investment-grade banks. As of December 31, 2011, certain of the Company’s deposits in U.S. bank accounts exceeded the FDIC guarantee of \$250 per depositor.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts Receivable are recorded at cost, and do not bear interest. Bad debt provisions are included in general and administrative expense. The amounts recorded are derived based upon the general aging of receivables, specific customer credit history and payment trends, and any new business conditions.

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Inventories

Inventories are generally valued at the lower of cost or market using the first-in, first-out (FIFO) method. Raw materials are valued principally on a weighted average cost basis. The Company's work in process and finished goods are specifically identified and valued based on actual inputs to production. Provisions are recorded as appropriate to write-down obsolete and excess inventory to estimated net realizable value. The process for evaluating obsolete and excess inventory often requires management to make subjective judgments and estimates concerning future sales levels, quantities and prices at which such inventory will be able to be sold in the normal course of business, while considering the general aging of inventory and factoring in any new business conditions.

Financial Instruments

The carrying value of cash and cash equivalents, trade receivables, other current assets, accounts payable, notes payable and amounts included in accruals meeting the definition of a financial instrument under U.S. GAAP approximate fair value due to their short-term nature. The carrying value of long-term debt is greater than its fair value (see Note 7). The Company determines estimated fair values based upon quoted market values where applicable or management estimates.

Long-lived Assets

Property and equipment

Property and equipment are recorded at cost. Property and equipment acquired in connection with acquisitions are recorded at fair value as of the date of the acquisition, and subsequent additions are recorded at cost. Depreciation is computed using the straight-line method over the following estimated useful lives:

<u>Asset</u>	<u>Years</u>
Buildings and improvements	3-50
Machinery and equipment— Heavy	16-25
— General	13-15
— Light	6-12
— Molds, tools, office and computers	2-5

Assets held for sale or sold

During the third quarter of 2011, the Company sold its Geelong, Australia facility for a net purchase price of \$5.4 million that resulted in a gain of \$0.4 million. The Company entered into a separate lease agreement in the third quarter of 2011 with the purchaser whereby the Company is leasing back this sold property from the purchaser for a period of five years with annual lease payments of \$0.5 million. In accordance with ASC 840-40, *Sale-leaseback Transactions*, the Company deferred the gain on the sale of \$0.4 million and will recognize this over the life of the lease as a reduction to rent expense. In addition, a vacant facility in Vietnam with a carrying value of \$3.0 million is held for sale at December 31, 2010 and 2011.

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Impairment

The Company reviews its long-lived assets that have finite lives for impairment in accordance with ASC Topic 360, *Property, Plant, and Equipment* (“Topic 360”). This topic requires that companies evaluate the fair value of long-lived assets based on the anticipated undiscounted future cash flows to be generated by the assets when indicators of impairment exist to determine if there is impairment to the carrying value. Any change in the carrying amount of an asset as a result of the Company’s evaluation has been recorded in restructuring and impairments expense in the consolidated statements of operations. Impairment charges are discussed in Note 14.

Intangible assets

Intangible assets consist of patents, licenses, trademarks and deferred financing costs. Patents, licenses and trademarks are amortized on a straight-line basis over their remaining lives, which range from three to fifteen years. Deferred financing costs are amortized using the effective interest method as a component of interest expense over the life of the related debt.

Goodwill

The Company accounts for goodwill and other intangible assets in accordance with ASC Topic 350, *Intangibles—Goodwill and Other Intangible Assets* (“Topic 350”). Topic 350 requires that goodwill and intangible assets that have indefinite lives not be amortized but, instead, must be tested at least annually for impairment or whenever events or business conditions warrant. Goodwill impairment testing is a two-step process. Step 1 involves comparing the fair value of the Company’s reporting unit to its carrying amount. If the fair value of the reporting unit is greater than its carrying amount, there is no impairment. If the reporting unit carrying amount is greater than the fair value then the second step must be completed to measure the amount of impairment, if any. Step 2 calculates the implied fair value of goodwill by deducting the fair value of the net assets of the reporting unit from the fair value of the reporting unit as determined in Step 1. The implied fair value of goodwill determined in this step is compared to the carrying value of goodwill. If the implied fair value of goodwill is less than the carrying value of goodwill, an impairment loss is recognized equal to the difference. The Company performs an annual test for goodwill impairment as of December 31st at the reporting unit level. The Company has two reporting units: clothing and roll covers. For the purpose of performing the annual impairment test, the Company allocates all shared assets and liabilities to the reporting units based on the percentage of each reporting unit’s revenue to total revenue. Shared operating expenses are allocated to the reporting unit to the extent necessary to allow them to operate as independent businesses. To determine if impairment exists, the fair value of each reporting unit is compared to its carrying value. The fair value of the Company’s reporting unit is determined by using a weighted combination of both a market multiple approach and an income approach. The market multiple approach utilizes the Company’s and its competitors’ proprietary information that is used to value its reporting units. The income approach is a present value technique used to measure the fair value of future cash flows produced by each reporting unit. As a result of the annual tests for goodwill impairment performed as of December 31, 2011 and December 31, 2010, the Company determined that no goodwill impairment exists.

As of December 31, 2009, the Company recorded a non-cash charge for goodwill impairment of \$80,600 related to its roll covers reporting unit based on assessments performed as of that date. Applying the guidance of Topic 350, the Company determined that as of December 31, 2009, goodwill for the roll covers segment was impaired primarily due to the adverse effect of the Company’s credit issues and the effects of the current global economic environment. Step 1 of the process indicated that the fair value of the net assets of the roll covers

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segment was \$3,600 less than their carrying value as of December 31, 2009. Based on the Step 1 result, the Company proceeded with Step 2. Based on the increase in fair value of tangible and intangible assets over book value of \$77,000 as determined in Step 2, an aggregate impairment of \$80,600 was recorded.

Other than above, to date, there have been no indicators of impairment or recorded goodwill impairment for the Company's clothing segment.

Stock-Based Compensation

The Company records stock-based compensation expense in accordance with ASC Topic 718, *Compensation—Stock Compensation* ("Topic 718") which generally requires that such transactions be recognized in the statement of operations based on their fair values at the date of grant. See Note 13 for further discussion.

Net Income (Loss) Per Common Share

Net income (loss) per common share has been computed and presented pursuant to the provisions of ASC Topic 260, *Earnings per Share* ("Topic 260"). Net income (loss) per share is based on the weighted-average number of shares outstanding during the period.

As of December 31, 2011, 2010 and 2009, the Company had outstanding restricted stock units ("RSUs") (See Note 13). Diluted average shares outstanding were computed using (i) the average market price for time-based RSUs and (ii) the actual grant date market price for non-employee director RSUs. The calculation of diluted earnings per share excludes the Company's performance-based RSUs that are based on shareholder return targets because the performance criteria had not been contingently achieved and therefore the RSUs were not contingently issuable. For the years ended December 31, 2010 and 2009, the dilutive effect of potential future issuances of common stock underlying the Company's RSUs was excluded from the calculation of diluted average shares outstanding because their effect would have been anti-dilutive as the Company incurred a net loss during those years.

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Weighted-average common shares outstanding—basic	15,079,771	10,019,098	2,445,381
Dilutive effect of stock-based compensation awards outstanding	4,064	—	—
Weighted-average common shares outstanding—diluted . . .	<u>15,083,835</u>	<u>10,019,098</u>	<u>2,445,381</u>

Dilutive securities aggregating approximately 1.9 million and 2.0 million outstanding during the years ended December 31, 2011 and 2010, respectively, were not included in the computation of diluted earnings per share because the impact would be anti-dilutive to the earnings per share calculation. In 2009, only a nominal amount of dilutive securities were outstanding, but were not included in the computation of diluted earnings per share because the impact would be anti-dilutive to the earnings per share calculation.

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Income Taxes

The Company accounts for income taxes in accordance with ASC Topic 740, *Income Taxes* ("Topic 740"), which requires the recognition of deferred tax assets and liabilities for the expected future consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets, representing future tax benefits, are reduced by a valuation allowance when the determination can be made that it is "more likely than not" that all or a portion of the related tax asset will not be realized. The deferred tax provision or benefit represents the annual change in deferred tax assets and liabilities, excluding any amounts accounted for as components of goodwill or accumulated other comprehensive income (loss), including the effect of foreign currency translation thereon. While the Company believes it has adequately provided for its income tax receivable or liabilities and its deferred tax assets or liabilities in accordance with FASB income tax guidance, adverse determination by taxing authorities or changes in tax laws and regulations could have a material adverse effect on the Company's consolidated financial condition, results of operations or cash flows. Income taxes are further discussed in Note 9.

Warranties

The Company offers warranties on certain products that it sells. The specific terms and conditions of these warranties vary depending on the product sold, the country in which the product is sold and arrangements with the customer. The Company estimates the costs that may be incurred under its warranties and records a liability for such costs. Factors that affect the Company's warranty liability include the number of units sold, historical and anticipated rates of warranty claims, cost per claim and new product introduction. The Company periodically assesses the adequacy of its recorded warranty claims and adjusts the amounts as necessary. Below represents the changes in the Company's warranty liability for 2011 and 2010:

	<u>Balance at Beginning of Year</u>	<u>Charged to Revenue or Cost of Sales</u>	<u>Effect of Foreign Currency Translation</u>	<u>Deduction from Reserves</u>	<u>Balance at End of Year</u>
For the year-ended December 31, 2011	\$1,688	\$2,586	\$(31)	\$(2,122)	\$2,121
For the year-ended December 31, 2010	\$1,973	\$1,472	\$(95)	\$(1,662)	\$1,688

Commitments and Contingencies

The Company provides accruals for all direct costs associated with the estimated resolution of contingencies at the earliest date at which it is deemed probable that a liability has been incurred and the amount of such liability can be reasonably estimated. Costs accrued have been estimated based on consultation with legal counsel and are based upon an analysis of potential results, assuming a combination of litigation and settlement strategies and outcomes.

Reclassifications

Certain prior year balances have been reclassified to conform to the current year presentation.

New Accounting Standards

On December 16, 2011, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update (ASU) No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities* ("ASU 2011-11"). ASU 2011-11 requires an entity to disclose information about offsetting and related

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arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The effective date of this update is for fiscal years and interim periods within those years, beginning after January 1, 2013, and interim periods within those annual periods. The Company is currently evaluating the impact on its consolidated financial statements.

On December 23, 2011, the Financial FASB issued Accounting Standards Update (ASU) No. 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05* ("ASU No. 2011-12"). The amendments are being made to allow the FASB time to re-deliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. The effective date of this update is for fiscal years and interim periods within those years, beginning after December 15, 2011. The Company is currently evaluating the impact on its consolidated financial statements.

3. Inventories

The components of inventories are as follows at:

	December 31,	
	2011	2010
Raw materials	\$19,872	\$ 19,144
Work in process	26,326	27,065
Finished goods (includes consigned inventory of \$12,953 in 2011 and \$11,784 in 2010)	37,119	35,718
	<u>\$83,317</u>	<u>\$ 81,927</u>

4. Property and Equipment

Property and equipment consist of the following at:

	December 31,	
	2011	2010
Land	\$ 22,638	\$ 23,915
Building and improvements	145,113	152,867
Machinery and equipment	621,794	614,585
Construction in progress	10,660	16,923
Total	800,205	808,290
Less accumulated depreciation	(464,949)	(447,020)
	<u>\$ 335,256</u>	<u>\$ 361,270</u>

The Company recorded \$41.4 million and \$39.0 million in depreciation expense in 2011 and 2010, respectively.

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5. Goodwill, Intangible Assets and Deferred Financing Costs

At December 31, 2011, the Company had cumulative goodwill impairment totaling \$265.9 million. The following table provides changes in the carrying amount of goodwill by segment for the years ended December 31, 2011 and 2010:

	<u>Clothing</u>	<u>Roll Covers</u>	<u>Total</u>
Balance at December 31, 2009	\$ 52,469	\$19,835	\$ 72,304
Goodwill Impairment	—	—	—
Foreign currency translations	(10,905)	(441)	(11,346)
Balance at December 31, 2010	41,564	19,394	60,958
Goodwill Impairment	—	—	—
Foreign currency translations	(1,624)	(214)	(1,838)
Balance at December 31, 2011	<u>\$ 39,940</u>	<u>\$19,180</u>	<u>\$ 59,120</u>

The components of intangible assets and deferred financing costs are summarized as follows at:

	<u>December 31,</u>	
	<u>2011</u>	<u>2010</u>
Patents and licenses	\$ 31,920	\$ 31,920
Less accumulated amortization	(28,607)	(27,655)
Net patents and licenses	<u>3,313</u>	<u>4,265</u>
Trademarks	18,920	18,920
Less accumulated amortization	(15,245)	(13,985)
Net trademarks	<u>3,675</u>	<u>4,935</u>
Other intangibles	951	952
Less accumulated amortization	(469)	(379)
Net other intangibles	<u>482</u>	<u>573</u>
Deferred financing costs	17,062	3,716
Less accumulated amortization	(1,892)	(531)
Net deferred financing costs	<u>15,170</u>	<u>3,185</u>
Net amortizable intangible assets and deferred financing costs	<u>\$ 22,640</u>	<u>\$ 12,958</u>

Amortization expense for patents, licenses, trademarks and other intangibles amounted to \$2,305, \$2,318 and \$2,328 for the years ended December 31, 2011, 2010 and 2009, respectively.

As of December 31, 2011, the estimated annual amortization expense for patents, licenses and trademarks and other intangibles for each of the succeeding five years total \$6,271 as follows:

2012	\$ 2,296
2013	1,765
2014	1,514
2015	359
2016	337

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6. Notes Payable

There were no outstanding notes payable at December 31, 2011. At December 31, 2010, notes payable consisted of the following:

	Year Ended December 31, 2010
Unsecured notes (1)	\$184
Secured notes	—
Total	<u>\$184</u>

- (1) In 2010, unsecured notes payable consisted primarily of committed lines of credit at banks to fund short-term working capital needs. The weighted-average interest rate on outstanding notes payable borrowings in 2010 was 3.48%.

7. Debt

At December 31, 2011 and December 31, 2010, long-term debt consisted of the following:

	December 31,	
	2011	2010
Senior Bank Debt (Secured):		
First lien debt, payable quarterly, U.S. Dollar denominated—LIBOR (minimum 2.00%) plus 4.50% (6.5%) as of December 31, 2010	\$ —	\$ 59,701
Second lien debt, payable quarterly, U.S. Dollar denominated—LIBOR (minimum 2.00%) plus 6.25% (8.25%) as of December 31, 2010	—	228,248
Second lien debt, payable quarterly, Euro denominated—EURIBOR (minimum 2.00%) plus 6.25% (8.25%) as of December 31, 2010	—	137,814
Second lien debt, payable quarterly, Canadian Dollar denominated—CDOR (minimum 2.00%) plus 6.25% (8.25%) as of December 31, 2010	—	49,800
First lien debt, payable quarterly, U.S. Dollar denominated—LIBOR (minimum 1.25%) plus 4.25% (5.50%) as of December 31, 2011	119,366	—
First lien debt, payable quarterly, Euro denominated—EURIBOR (minimum 1.25%) plus 4.25% (5.75%) as of December 31, 2011	107,771	—
	<u>227,137</u>	<u>475,563</u>
Senior Notes (Unsecured), payable semi-annually—U.S. Dollar denominated interest rate fixed at 8.875%, matures June of 2018	240,000	—
Other Long-Term Debt:		
Unsecured, interest rate fixed at 2.00%, Euro denominated	228	2,035
Unsecured, interest rate fixed at 1.31% to 3.40%, Yen denominated	1,689	3,579
	<u>469,054</u>	<u>481,177</u>
Less current maturities	3,548	12,794
Total	<u>\$465,506</u>	<u>\$468,383</u>

During 2011, 2010 and 2009, the Company recorded \$39.5 million, \$57.9 million, and \$68.5 million in interest expense, respectively.

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On May 26, 2011, the Company completed a refinancing, which replaced certain of its Prior Credit Facility and Exit Facility with a private offering of the Notes and the Credit Facility. See Note 1 for further discussion.

The interest rates under the Credit Facility are calculated, at our option, as the Alternate Base Rate as defined in the Credit Facility, LIBOR or EURIBOR, subject to a minimum of 2.25%, 1.25% and 1.25%, respectively, plus, in each case, a margin. The Company paid \$17.1 million in deferred financing costs related to the Notes and Credit Facility. This amount is classified as an intangible asset in the Condensed Consolidated Balance Sheet at December 31, 2011. In addition, in accordance with ASC 470-50, *Modifications and Extinguishments of Debt*, the Company wrote off \$2.9 million of deferred financing costs related to its previous indebtedness as a result of this refinancing. This amount has been classified as a loss on extinguishment of debt in the December 31, 2011 Condensed Consolidated Statement of Operations.

As of December 31, 2011, an aggregate of \$17.1 million is available for additional borrowings under the Credit Facility. This availability represents the \$30.0 million Revolving Facility (as defined below) less \$12.9 million of that facility committed for letters of credit.

Notes

Interest on the Notes is payable semiannually in cash in arrears on June 15 and December 15 of each year, and commenced on December 15, 2011. The Notes are the Company's senior unsecured obligations, and are guaranteed by each of the Company's direct and indirect wholly-owned domestic subsidiaries. They rank equal in right of payment with the Company's existing and future senior indebtedness and senior in right of payment to any of the Company's existing and future subordinated indebtedness. The Notes are effectively subordinated to all of the Company's secured debt, including the Credit Facility and related guarantees, to the extent of the value of the assets securing such debt and structurally subordinated to all of the existing and future liabilities of its subsidiaries that do not guarantee the Notes. Subject to the terms of the Credit Facility, the Notes may be redeemed by the Company at specified redemption prices which vary depending on the timing of the redemption.

The Notes contain covenants, subject to certain exceptions, that restrict the Company's ability and the ability of certain of its subsidiaries to, among other things:

- incur or guarantee additional indebtedness or issue preferred stock;
- pay dividends or make other distributions to stockholders;
- purchase or redeem capital stock or subordinated indebtedness;
- make certain investments;
- create liens;
- incur restrictions on the ability of our subsidiaries to make dividends or make other payments to us;
- sell assets or engage in sale-leaseback transactions;
- consolidate or merge with or into other companies or transfer all or substantially all of its assets; and
- engage in certain transactions with affiliates.

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Credit Facility

The Credit Facility provides for:

- a six-year \$125.0 million senior secured term loan facility, borrowed by the Company, the proceeds of which were used to refinance certain of its existing indebtedness (the “U.S. Term Loan”);
- a six-year €87.0 million senior secured term loan facility, borrowed by Xerium Technologies Limited, a wholly-owned indirect subsidiary of the Company organized under the laws of England and Wales, the proceeds of which were used to refinance certain of the Company’s existing indebtedness (the “Euro Term Loan” and together with the U.S. Term Loan, the “Term Loans”);
- a five-year \$30.0 million senior secured revolving credit facility, available to the Company, and an uncommitted incremental amount of \$10 million, the proceeds of which will be used for working capital and general corporate purposes and include sub-limits available for letters of credit (the “Revolving Facility”); and
- an uncommitted incremental credit facility (the “Incremental Facility”) allowing for increases under the Revolving Facility and Term Loans with the same terms, and borrowing of new tranches of term loans, up to an aggregate principal amount not to exceed the greater of (i) \$100.0 million and (ii) the Company’s Adjusted EBITDA (as defined in the Credit Facility) over the prior 12-month period, provided that increases under the Revolving Facility shall not exceed \$35.0 million.

The loans under the Credit Facility are required to be permanently repaid with 100% of the net proceeds of assets sales, dispositions, issuances of certain debt obligations and insurance, in each case, subject to certain exceptions and 50% of annual excess cash flows (as specified in the Credit Facility) subject to certain adjustments.

The obligations under the Credit Facility are guaranteed by all of the Company’s existing and future direct and indirect subsidiaries that are organized in the United States (subject to certain exceptions in the case of immaterial subsidiaries and joint ventures) and certain of its direct and indirect foreign subsidiaries, provided that non-U.S. guarantors are only liable for obligations of Xerium Technologies Limited and certain other non-U.S. guarantors.

In addition, the obligations under the Credit Facility are secured by a first-priority perfected security interest in substantially all of the assets of the Company, Xerium Technologies Limited and such subsidiary guarantors (collectively, the “Loan Parties”), in each case, now owned or later acquired, subject to certain exceptions and legal and tax considerations and requirements, including that only 66% of the voting capital stock of the domestic Loan Parties’ “first-tier” non-U.S. subsidiaries are pledged in respect of the obligations of the Company and the U.S. guarantors under the Credit Facility.

Our Credit Facility include a number of customary and significant restrictions and covenants, subject to certain restrictions, that limit our ability to, among other things:

- incur or guarantee additional indebtedness;
- pay dividends or distributions on capital stock or redeem or repurchase capital stock;
- make investments;
- create restrictions on the payment of dividends or other amounts to us;
- sell stock of our subsidiaries;
- transfer or sell assets;

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- create liens;
- enter into certain transactions with affiliates; and
- enter into mergers or consolidations.

The Credit Facility includes specified financial covenants, requiring the Company to maintain certain consolidated leverage and interest coverage ratios and limiting its ability to make capital expenditures in excess of specified amounts.

In addition, the Credit Facility contains, among other restrictions, certain customary representations and warranties, affirmative covenants and events of default, including payment defaults, breaches of representations and warranties, covenant defaults, cross-defaults and cross-acceleration to certain indebtedness, and certain events of bankruptcy, and certain events under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), material judgments, actual or asserted failures of any guarantee or security document supporting the Credit Facility to be in full force and effect and a change in control. If an event of default occurs, the lenders under the Credit Facility would be entitled to take various enforcement actions, including acceleration of amounts due under the Credit Facility and all actions permitted to be taken by a secured creditor.

The aggregate scheduled principal payments over the term of the Credit Facility, the Notes and other existing debt are shown below:

	Total Scheduled Principal Payments including balloon payments (in USD)
2012	\$ 3,548
2013	3,129
2014	2,381
2015	2,381
2016	2,381
2017 and thereafter	455,234
	<u>\$469,054</u>

Additionally, the following table outlines the estimated future interest payments to be made under the Credit Facility and Notes over the term of the obligations:

	Total Estimated Interest Payments Converted into U.S. Dollars at December 31, 2011 Exchange Rates (in USD thousands)
2012	\$ 34,485
2013	34,307
2014	34,217
2015	34,081
2016	33,946
2017 and thereafter	36,829
	<u>\$207,865</u>

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As of December 31, 2011 and December 31, 2010, the carrying value of the Company's long-term debt is \$469.1 million and \$481.2 million, respectively, and exceeds its fair value of approximately \$439.1 million and \$470.2 million, respectively. The Company determined the fair value of its debt utilizing significant other observable inputs (Level 2 of the fair value hierarchy).

8. Derivatives and Hedging

Risk Management Objective of Using Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. From time to time, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known cash amounts, the value of which are determined by interest rates or foreign exchange rates.

Cash Flow Hedges of Interest Rate Risk

The Company's objectives when using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company may use interest rate caps and interest rate swaps as part of its interest rate risk management strategy. Interest rate caps designated as cash flow hedges protect the Company from increases in interest rates above the strike rate of the interest rate cap. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

On August 8, 2011, the Company entered into two interest rate cap agreements with certain financial institutions, with notional amounts totaling \$114.4 million, whereby the Company limits its variable interest rate exposure to the strike rate of the interest rate cap agreements. Under the terms of the interest rate cap agreements, the Company will receive payments based on the spread in rates if the three-month LIBOR rate increases above the negotiated cap rates of 3.0%. The interest rate caps are considered designated hedging instruments, classified as Level 2 in the fair value hierarchy. Changes in fair value will be deferred in other comprehensive income and the cap purchase price will be reclassified from other comprehensive income into earnings as interest expense over the life of the agreements. The fair value of the interest rate caps was \$175 at December 31, 2011. An unrecognized loss of (\$520) was recorded in other comprehensive income at December 31, 2011.

The Company had previously entered into interest rate swaps to hedge variable interest related to its prior senior debt and foreign exchange contracts to protect the U.S. dollar value of certain assets and obligations. On December 31, 2009, the Company terminated with the counterparties all of its outstanding interest rate swap liabilities of \$20,036 and converted them into notes payable to such counterparties. The Company has not entered into any new interest rate swap agreements since that time.

The Company's prior interest rate swaps were considered designated hedging instruments through August 31, 2009. Effective September 1, 2009, the interest rate swaps were no longer designated hedging instruments. During 2010, the Company amortized the mark to market balances related to these interest rate swaps from accumulated other comprehensive income to interest expense. The Company recognized an expense of \$9,721 related to its derivative financial instruments in the year ended December 31, 2010, which was included in interest expense in its Condensed Consolidated Statements of Operations for those same periods. In

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addition, the year ended December 31, 2010 Condensed Consolidated Statements of Operations included the amortization of an additional \$735 from accumulated other comprehensive income to interest expense, as the Company determined it was probable that interest payments on certain debt would not occur.

Although these interest rate swaps were subject to mark to market accounting through earnings effective September 1, 2009, prior to their termination with the counterparties as discussed above, they effectively fixed, from a cash flow hedge perspective through December 31, 2010, the interest rate at 10.75% on approximately 79% of the term loan portion of the Company's pre-petition credit facility. As a result of the termination of the interest rate swaps, the interest rate on the term loan portion of the Prior Credit Facility was no longer effectively fixed through December 31, 2010, the original term of the swaps.

Non-designated Hedges of Foreign Exchange Risk

Derivatives not designated as hedges are not speculative and are used to manage the Company's exposure to foreign exchange rates, but do not meet the strict hedge accounting requirements of Topic 815. Changes in the fair value of derivatives not designated in hedging relationships are recorded directly to earnings.

The Company, from time to time, may enter into foreign exchange forward contracts to fix currencies at specified rates based on expected future cash flows to protect against the fluctuations in cash flows resulting from sales denominated in foreign currencies (cash flow hedges). Additionally, to manage its exposure to fluctuations in foreign currency on intercompany balances and certain purchase commitments, the Company from time to time may use foreign exchange forward contracts (fair value hedges).

As of December 31, 2011 and December 31, 2010, the Company had outstanding derivatives that were not designated as hedges in qualifying hedging relationships. The value of these contracts is recognized at fair value based on market exchange forward rates and is recorded in other assets (liabilities) on the Condensed Consolidated Balance Sheet. The fair value of these derivatives at December 31, 2011 and December 31, 2010 was \$123 and \$(222), respectively. The change in fair value of these contracts is included in foreign exchange gain (loss) and was \$(1,061) and \$(261) for the years ended December 31, 2011 and 2010, respectively, and is recorded in the Condensed Consolidated Statements of Operations.

The following represents the notional amounts sold and purchased for the year ended December 31, 2011:

<u>Foreign Currency Derivative (as of December 31, 2011)</u>	<u>Notional Sold</u>	<u>Notional Purchased</u>
Cash flow hedges	\$ (6,688)	\$ —
Fair value hedges	\$(28,925)	\$2,987

Fair Value of Derivatives Under ASC Topic 820

ASC Topic 820, *Fair Value Measurements and Disclosures* ("Topic 820"), emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, Topic 820 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

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Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs including fair value of investments that do not have the ability to redeem at net asset value as of the measurement date, or during the first quarter following the measurement date. The derivative assets or liabilities are typically based on an entity's own assumptions, as there is little, if any, market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and the Company considers factors specific to the asset or liability.

To comply with Topic 820, the Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilized Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of December 31, 2011 and December 31, 2010, respectively, the Company assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments were not significant to the overall valuation of its derivatives. As a result, the Company determined that its derivative valuations in their entirety were classified in Level 2 of the fair value hierarchy. The Company does not have any derivatives valued using significant unobservable inputs (Level 3) as of December 31, 2011 or December 31, 2010. The table below presents the Company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2011 and December 31, 2010, aggregated by the level in the fair value hierarchy within which those measurements fall.

As of December 31, 2011

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Derivatives	\$ 630	\$—	\$ 630	\$—
Total	<u>\$ 630</u>	<u>\$—</u>	<u>\$ 630</u>	<u>\$—</u>
Liabilities				
Derivatives	\$(507)	\$—	\$(507)	\$—
Total	<u>\$(507)</u>	<u>\$—</u>	<u>\$(507)</u>	<u>\$—</u>

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As of December 31, 2010

		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets	Total			
Derivatives	\$ 35	\$—	\$ 35	\$—
Total	<u>\$ 35</u>	<u>\$—</u>	<u>\$ 35</u>	<u>\$—</u>
Liabilities				
Derivatives	\$(257)	\$—	\$(257)	\$—
Total	<u>\$(257)</u>	<u>\$—</u>	<u>\$(257)</u>	<u>\$—</u>

9. Income Taxes

The components of domestic and foreign income (loss) before the provision for income taxes are as follows:

	Year ended December 31,		
	2011	2010	2009
U.S.	\$(21,683)	\$(75,616)	\$(92,453)
Foreign	40,552	20,796	(7,223)
Total	<u>\$ 18,869</u>	<u>\$(54,820)</u>	<u>\$(99,676)</u>

The components of the income tax provision (benefit) are as follows:

	Year ended December 31,		
	2011	2010	2009
Current:			
U.S.	\$ 788	\$ 1,088	\$ 222
Foreign	9,557	8,564	4,509
Total current	10,345	9,652	4,731
Deferred:			
U.S.	(93)	—	—
Foreign	427	8,614	7,586
Total deferred	334	8,614	7,586
Total provision	<u>\$10,679</u>	<u>\$18,266</u>	<u>\$12,317</u>

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The tax effect of temporary differences which give rise to deferred income tax assets and liabilities are as follows:

	<u>2011</u>	<u>2010</u>
Deferred tax assets arising from:		
Loss carryforwards	\$111,409	\$100,974
Intangible assets, net	8,744	12,293
Pension and other benefit accruals	18,611	10,994
Tax credits	1,576	1,711
Investments	4,285	6,766
Interest and finance fees	2,076	4,690
Other allowances and accruals, net	8,975	13,935
Total	155,676	151,363
Deferred tax liabilities arising from:		
Property and equipment, net	34,498	36,628
Intangible assets, net	2,570	2,628
Foreign income inclusions	22,387	22,372
Other allowances and accruals, net	337	1,312
Total	59,792	62,940
Valuation allowance	105,388	96,042
Net deferred tax liability	<u>\$ 9,504</u>	<u>\$ 7,619</u>

Deferred taxes are recorded as follows in the consolidated balance sheets:

	<u>2011</u>	<u>2010</u>
Current Deferred Tax Asset, Net	\$ 6,455	\$ 7,059
Current Deferred Tax Liability, Net	855	679
Noncurrent Deferred Tax Asset, Net	3,478	3,776
Noncurrent Deferred Tax Liability, Net	18,582	17,775
Net Deferred Tax Liability	<u>\$ 9,504</u>	<u>\$ 7,619</u>

The Company utilizes the asset and liability method for accounting for income taxes in accordance with ASC Topic 740, *Income Taxes* ("Topic 740"). Under Topic 740, deferred tax assets and liabilities are determined based on the difference between their financial reporting and tax basis. The assets and liabilities are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company reduces its deferred tax assets by a valuation allowance if, based upon the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. In making this determination, the Company evaluates all available information including the Company's financial position and results of operations for the current and preceding years, as well as any available projected information for future years.

As of December 31, 2011, the Company had a valuation allowance in place for certain of its deferred tax assets due to the Company's accumulated loss position, and its uncertainty around the future profitability in certain of its tax jurisdictions. The valuation allowance primarily relates to deferred tax assets for available net

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operating loss carry forwards in the United States, the United Kingdom, Canada, Germany, Sweden, France and Australia. While the Company believes it has adequately provided for its income tax assets and liabilities in accordance with the FASB income tax guidance, it recognizes that adverse determinations by taxing authorities, or changes in tax laws and regulations could have a material adverse effect on its consolidated financial position, results of operations or cash flows.

For the years ended December 31, 2011 and 2010, the provision for income taxes was \$10,679 and \$18,266, respectively. Our effective income tax rate for the year ended December 31, 2011 was 56.6% as compared with our effective rate for the year ended December 31, 2010 of (33.3)%. Our effective income tax rate is primarily impacted by income we earn in tax paying jurisdictions relative to income we earn in non-tax paying jurisdictions. The majority of income recognized for purposes of computing our effective tax rate is earned in countries where the statutory income tax rates range from 25% to 41%. However, permanent income adjustments recorded against pre-tax earnings may result in an effective tax rate that is higher or lower than the statutory tax rate in these jurisdictions. We generate losses in certain jurisdictions for which we receive no tax benefit as the deferred tax assets in these jurisdictions (including the net operating losses) are fully reserved in our valuation allowance. For this reason, we recognize minimal income tax expense or benefit in these jurisdictions, of which the most material jurisdictions are the United States, the United Kingdom and Australia. Due to these reserves, the geographic mix of our pre-tax earnings has a direct correlation with how high or low our annual effective tax rate is relative to consolidated earnings.

For the year ended December 31, 2011 and 2010, tax expense included a benefit of approximately \$328 and \$336 for a Chinese tax holiday scheduled to expire in the year ending December 31, 2012.

As of December 31, 2011, the Company had a gross unrecognized tax benefit of \$8,620, excluding interest and penalties. The unrecognized tax benefit decreased by approximately \$667 during the year ended December 31, 2011 as a result of foreign currency effects, statute expirations and ongoing changes in currently reserved positions.

As discussed in Note 1, the Company emerged from Chapter 11 bankruptcy protection on May 25, 2010. The Company's review of the potential impact of the overall plan of reorganization resulted in no material change in its tax position. In December 2010, as a result of the debt reorganization, the Company provided for the impairment of a portion of the deferred tax asset related to its German federal and trade loss carry forwards.

As of December 31, 2011, the Company has pre-tax net operating loss carry-forwards for U.S. federal income tax purposes of approximately \$172,847 that expire on various dates from 2026 through 2031 and federal tax credits of approximately \$167 that either expire on various dates or can be carried forward indefinitely. As of December 31, 2011, the pre-tax net operating loss carry-forwards and federal tax credits are fully reserved in our valuation allowance. The Company has foreign federal net operating loss carry-forwards of approximately \$137,009 and capital loss carry forwards of \$8,009, the majority of which can be carried forward indefinitely, and federal and provincial tax credits of approximately \$1,409 that begin to expire primarily in 2024 or are carried forward indefinitely. As of December 31, 2011, \$112,730, \$8,009 and \$1,396, of foreign federal net operating loss carry-forwards, capital loss carry-forwards and federal and provincial tax credits, respectively, are reserved in our valuation allowance.

Undistributed earnings of the Company's foreign subsidiaries amounted to approximately \$172,731 at December 31, 2011. Those earnings are considered to be indefinitely reinvested for continued use in foreign operations except for Argentina, Brazil and Mexico. To the extent earnings are considered to be indefinitely

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reinvested, no provision for income taxes or withholding taxes has been provided. Upon distribution of those earnings in the form of dividends or otherwise, the Company may be subject to both income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to the various jurisdictions. Determination of the amount of unrecognized deferred income tax liability or withholding taxes is not practicable because of the complexities associated with its hypothetical calculation; however, unrecognized foreign tax credit carry-forwards and net operating loss carry-forwards would be available to reduce some portion of the liability. Federal income taxes are provided on the portion of the income of foreign subsidiaries that is expected to be remitted to the United States and be taxable. The Company has not provided U.S. deferred taxes on cumulative earnings of foreign subsidiaries that it considers to be permanently reinvested. These earnings relate to on-going operations, and were approximately \$103,659 as of December 31, 2011.

The Company adopted the uncertain tax provisions of Topic 740 on January 1, 2007 and, accordingly, recorded a cumulative effect increase of \$3,323 to accumulated deficit, an increase of \$627 to income taxes payable and an increase of \$2,696 to other long-term liabilities for uncertain tax positions. On January 1, 2007, the Company had \$4,126 in unrecognized tax benefits. As of the December 31, 2011, the gross amount of unrecognized tax benefits was approximately \$8,620, exclusive of interest and penalties. Of this balance, if the Company were to prevail on all unrecognized tax benefits recorded, approximately \$8,620 would benefit the effective tax rate. As of December 31, 2010 the gross amount of unrecognized tax benefits was approximately \$9,287, exclusive of interest and penalties. Of this balance, if the Company were to prevail on all unrecognized tax benefits recorded, approximately \$8,947 would benefit the effective tax rate. The Company's unrecognized tax benefits decreased approximately \$667 and increased approximately \$4,264 during the years ended December 31, 2011 and 2010, respectively. During the next twelve months, management estimates \$268 of the Company's gross unrecognized tax benefit will reverse due to expiration of statutes and will benefit the effective tax rate. The Company regularly evaluates, assesses and adjusts the related liabilities in light of changing facts and circumstances, which could cause the effective tax rate to fluctuate from period to period.

The Company accrues for certain known and reasonably anticipated income tax obligations after assessing the likely outcome. In the event that actual results differ from these accruals or if the Company becomes subject to a tax obligation for which the Company has made no accrual, the Company may need to make adjustments, which could materially impact the financial condition and results of operations. For example, taxing authorities may disagree with the Company's tax accounting methodologies and may subject the Company to inquiries regarding such taxes, which potentially could result in additional income tax assessments. In accordance with ASC 740-10-25-6, the Company does not accrue for potential income tax obligations if management deems a particular tax position, based solely on its technical merits, is more likely than not to be sustained upon examination. In making this determination, the Company assumes that the taxing authorities will have access to all relevant facts and information in accordance with ASC 740-10-25-7.

The tax years 2000 through 2011 remain open to examination in our domestic jurisdictions and the tax years 2005 through 2011 remain open to examination in the major foreign taxing jurisdictions to which the Company and its subsidiaries are subject. There are currently no U.S. Federal or state audits or examinations underway.

In 2010, the German tax authorities initiated an audit of the Company's German entities for the tax years 2004 through 2007. For certain of those German entities under audit, the Company reached an agreement with the tax authorities for issues identified as a result of this audit, and in September 2010, the Company accrued for any taxes due as a result of this agreement. For the remaining German entities under audit, the Company received an initial assessment in December of 2011 and accrued for any taxes due as a result of this assessment.

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In November 2010, the Company concluded an audit relating to its Canadian subsidiary for tax years 2005 through 2007, and established a reserve in December 2010 to account for the resolution of this audit.

In November of 2011, the Federal Revenue Department of the Ministry of Finance of Brazil (“FRD”) issued a tax assessment against the Company’s indirect subsidiary, Xerium Technologies Brasil Indústria e Comércio S.A. (“Xerium Brazil”), challenging the goodwill recorded in the 2005 acquisition of Wangner Itelpa and Huyck Indústria e Comércio S.A. by Robec Brasil Participações Ltda. This assessment denies the amortization of that goodwill against net income for the years 2006 through 2010. In addition, the assessment seeks payment of approximately \$42,620 (subject to currency exchange rates) of tax, penalties and interest. The Company believes the transactions in question (i) complied with Brazilian tax and accounting rules, (ii) were effected for a legitimate business purpose, to consolidate the Company’s operating activities in Brazil into one legal entity, and (iii) were properly documented and declared to Brazilian tax and corporate authorities. Based on the foregoing, Xerium Brazil filed a response disputing the tax assessment at the first administrative level of appeal within the FRD in December 2011.

Although there can be no assurances, at year-end December 31, 2011 the Company believed it was more likely than not that it would prevail on every tax position under examination and therefore it did not accrue any amounts related to this assessment in 2011. Because this dispute is at a preliminary stage for resolution with the FRD, the Company cannot assure a favorable outcome and cannot currently estimate the timing of the final resolution of this matter. The Company believes it has meritorious defenses and will vigorously contest this matter. However, if the FRD’s initial position is sustained, the amount assessed would result in a material adjustment to the Company’s consolidated financial statements and would adversely impact the Company’s financial condition and results of operations.

The Company believes that it has made adequate provisions for all income tax uncertainties.

A reconciliation of the balances of the unrecognized tax benefits is as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Balance as of January 1	\$9,287	\$5,023	\$4,831
Gross decreases—tax positions in prior period due to settlements	34	(215)	(642)
Gross increases—tax positions in prior period-other	(195)	524	—
Gross decreases—related to lapse in statute of limitations	(549)	(565)	(206)
Gross increases—tax positions in current period	205	4,520	953
Currency effects	(162)	—	87
Balance at December 31	<u>\$8,620</u>	<u>\$9,287</u>	<u>\$5,023</u>

The Company’s policy is to recognize interest and penalties related to income tax matters as income tax expense and accordingly, the Company recorded a \$209 benefit and a \$328 expense for interest and penalties during the years ended December 31, 2011 and 2010, respectively. As of December 31, 2011 and 2010, the Company recorded accrued interest and penalties related to uncertain tax positions of approximately \$2,508 and \$2,732, respectively.

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The provision for income taxes differs from the amount computed by applying the U.S. statutory tax rate (35%) to income before income taxes, due to the following:

	Year ended December 31,		
	2011	2010	2009
Book income (loss) at U.S. 35% statutory rate	\$ 6,604	\$(19,187)	\$(34,874)
State income and other taxes due, net of federal benefit	1,070	1,710	955
Foreign tax rate differential	(1,799)	374	(7,137)
Dividends and other foreign income, net of foreign tax credits ...	2,638	7,975	721
Change in valuation allowance	910	(10,272)	24,418
Tax rate changes	2,263	124	41
Tax credits and refunds	(41)	(424)	(714)
Goodwill	(2,933)	(2,825)	25,985
Change in tax reserves	(343)	4,606	1,125
Provision to return adjustments	160	29,408	(124)
Other, net	2,150	400	1,921
Financing costs	—	6,377	—
Total	<u>\$10,679</u>	<u>\$ 18,266</u>	<u>\$ 12,317</u>

For the year ended December 31, 2011, we reported the tax effect for the change in valuation allowance and provision to return adjustments in the amounts of \$910 and \$160, respectively. Given that all U.S. deferred tax assets are fully reserved in the valuation allowance, the current year domestic loss resulted in an increase to the valuation allowance of approximately \$7,589. This increase was partially offset by domestic permanent income adjustments in 2011 primarily related to foreign income inclusions of (\$2,989) and state net operating loss of (\$1,648).

In 2011 there were approximately (\$11,117) of pre-tax losses generated in foreign jurisdictions where deferred tax assets are fully reserved. The net pretax losses generated in 2011 resulted in an increase in the available net operating loss carry-forward; however, given that all deferred tax assets were fully reserved in the valuation allowance for the aforementioned loss companies, these losses resulted in an increase to the valuation allowance of approximately \$3,891. This increase was offset by foreign adjustments in 2011 primarily related to changes in certain foreign tax rates of (\$2,278) and a deferred tax adjustment in Canada of (\$2,781).

These above mentioned adjustments do not have an impact on income tax expense or our effective tax rate as they were recorded in jurisdictions where we are fully reserved with regard to the valuation allowance. As such, all of the aforementioned adjustments net to \$0 in calculating our effective tax rate. As of December 31, 2011, the Company changed its position regarding the realizability of certain of its deferred tax assets resulting in additional valuation allowance recorded in 2011 of approximately \$71

For the year ended December 31, 2010, we reported the tax effect for the change in valuation allowance and provision to return adjustments in the amounts of (\$10,272) and \$29,408, respectively. In 2010, the U.S. entities had pre-tax loss of (\$75,611) as compared to pre-tax loss generated in 2009 of (\$92,453). The U.S. entities recorded permanent income adjustments in 2010, the most material of which was an adjustment of \$18,063 to reverse consolidating book eliminations that were not applicable for U.S. tax reporting purposes. The net pretax loss generated in 2010 resulted in an increase in the available net operating loss carry-forward. However, given

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that all U.S. deferred tax assets were fully reserved in the valuation allowance, this loss resulted in an increase to the valuation allowance of approximately \$10,847. The U.S. entities also recorded provision to return adjustments in 2010 (related to the 2009 return) that were primarily comprised of a provision to return adjustment to the net operating loss, recorded through the deferred tax asset with an offset to the valuation allowance. The amount the U.S. entities reversed in 2010 equaled \$10,095. In 2010 there were approximately (\$30,550) of pre-tax losses generated in foreign jurisdictions where the deferred tax assets are fully reserved in the valuation allowance. The pre-tax losses generated in 2010 created an increase in available foreign net operating loss carry-forwards; however, given that all deferred tax assets were fully reserved in the valuation allowance for the aforementioned loss companies, these losses resulted in an increase to the valuation allowance of approximately \$8,401. Additionally, in 2009, one of our U.K. subsidiaries recorded a write-down in one of its investments for statutory financial purposes. In 2010, upon finalization of the statutory audit and filing of the tax return, a provision to return adjustment was recorded through the deferred tax asset with an offset to the valuation allowance. The amount the U.K. entities reversed in 2010 equaled approximately \$19,361.

For the year ended December 31, 2009, we reported the tax effect for the change in valuation allowance and provision to return adjustments in the amounts of \$24,418 and (\$124), respectively. In 2009, the U.S. entities had a pre-tax loss of (\$92,453) as compared to pre-tax income in 2008 of \$29,538. The U.S. entities recorded permanent income adjustments in 2009, the most material of which was an adjustment of \$31,208 to reverse consolidating book eliminations recorded in the U.S. entities that were not applicable for U.S. tax reporting purposes. The net pre-tax loss generated in 2009 created an increase in the available U.S. net operating loss carry-forward; however, given that all U.S. deferred tax assets were fully reserved in the valuation allowance, this loss resulted in an increase in the valuation allowance of approximately \$15,286. Additionally, in 2009, there were approximately (17,498) of pre-tax losses generated in foreign jurisdictions where the deferred tax assets were fully reserved in the valuation allowance. These foreign pre-tax losses resulted in an additional increase in the valuation allowance of approximately \$5,124.

10. Pensions, Other Postretirement and Postemployment Obligations

Pension Plans

The Company has defined benefit pension plans covering substantially all of its U.S. and Canadian employees, and employees of certain subsidiaries in other countries. Benefits are generally based on the employees' years of service and compensation. These plans are funded in conformity with the funding requirements of applicable government regulations.

The Company does not fund certain plans, as funding is not required. Approximately \$45,900 of the total underfunded status of \$82,000 and \$46,000 of the total underfunded status of \$70,400 relate to the unfunded pension plans for December 31, 2011 and 2010, respectively. The Company plans to continue to fund its U.S. defined benefit plans to comply with the Pension Protection Act of 2006. In addition, the Company also intends to fund its UK and Canadian defined benefit plans in accordance with local regulations. Additional discretionary contributions are made when deemed appropriate to meet the long-term obligations of the plans.

The Company also provides additional unfunded supplemental retirement benefits to one of its officers and certain other former employees, which have been included in the benefit costs below.

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Postretirement Plans

In addition to defined benefit pension plans, the Company sponsors various unfunded defined contribution plans that provide for retirement benefits to employees, some in accordance with local government requirements.

In accordance with the provisions of ASC Topic 715-20-50, *Compensation—Retirement Benefits* (“Topic 715”), the measurement date for defined benefit plans outside the U.S. is December 31 for the years ended December 31, 2011, 2010 and 2009.

Postemployment Obligations

The Company has postemployment plans in various countries and accounts for these plans in accordance with Topic 715. The Company’s postemployment obligations consist primarily of payments to be made to employees upon termination of employment, as defined, and are accrued according to local statutory laws in the respective countries. The Company’s obligation for postemployment benefits amounted to \$1,915 and \$1,992 as of December 31, 2011 and 2010, respectively.

Benefit Obligations and Plan Assets

A summary of the changes in benefit obligations and plan assets as of December 31, 2011 and 2010 is presented below.

	Defined Benefit Plans		Other Postretirement Benefit Plan	
	2011	2010	2011	2010
Change in benefit obligation				
Benefit obligation at beginning of year	\$140,497	\$133,097	\$ 555	\$ 558
Service cost	3,409	3,570	—	—
Interest cost	6,945	6,843	24	26
Plan participants’ contributions	119	109	—	—
Actuarial (gain) loss	12,799	8,061	9	(9)
Currency translation impact	(845)	(2,844)	—	—
Settlement/curtailment gain	(649)	(32)	—	—
Administrative expenses paid	(603)	(493)	—	—
Benefits paid	(7,204)	(7,814)	(3)	(20)
Benefit obligation at end of year	<u>\$154,468</u>	<u>\$140,497</u>	<u>\$ 585</u>	<u>\$ 555</u>
Change in plan assets				
Fair value of plan assets at beginning of year	\$ 70,084	\$ 61,312	\$ —	\$ —
Actual return on plan assets	1,912	7,341	—	—
Employer contributions	8,937	9,899	—	—
Plan participants’ contributions	119	109	—	—
Settlement	(649)	—	—	—
Administrative expenses paid	(603)	(493)	—	—
Currency translation impact	(119)	(270)	—	—
Benefits paid	(7,204)	(7,814)	—	—
Fair value of plan assets at end of year	<u>\$ 72,477</u>	<u>\$ 70,084</u>	<u>\$ —</u>	<u>\$ —</u>
Funded status (1)	<u><u>\$ (81,991)</u></u>	<u><u>\$ (70,413)</u></u>	<u><u>\$ (585)</u></u>	<u><u>\$ (555)</u></u>

(1) In accordance with Topic 715, \$3,519 and \$3,591 of this amount is recorded in accrued expenses as of December 31, 2011 and 2010, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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All of the Company's pension plans that comprise the pension obligation amounts above, have a projected benefit obligation equal to or in excess of plan assets as of the years ended December 31, 2011 and 2010. The accumulated benefit obligation was \$145,254 and \$131,844 as of the years ended December 31, 2011 and 2010, respectively.

Information for pension plans with an accumulated benefit obligation in excess of plan assets is as follows:

	December 31,	
	2011	2010
Projected benefit obligation	\$154,468	\$140,497
Accumulated benefit obligation	145,254	131,884
Fair value of plan assets	72,477	70,084

Components of Net Periodic Benefit Cost

	Defined Benefit Plan			Other Postretirement Benefit Plans		
	2011	2010	2009	2011	2010	2009
Service cost	\$ 3,409	\$ 3,570	\$ 2,986	\$—	\$—	\$—
Interest cost	6,945	6,843	6,718	24	26	84
Expected return on plan assets	(5,113)	(4,409)	(3,792)	—	—	—
Amortization of prior service cost	14	15	38	—	—	—
Amortization of net (gain) loss	1,378	982	1,230	(9)	(7)	(4)
Curtailment loss	—	126	282	—	—	—
Net periodic benefit cost	<u>\$ 6,633</u>	<u>\$ 7,127</u>	<u>\$ 7,462</u>	<u>\$ 15</u>	<u>\$ 19</u>	<u>\$ 80</u>

For defined benefit plans, the estimated net loss and prior service cost to be amortized from accumulated other comprehensive loss during 2012 is expected to be \$2,279 and \$14, respectively (unaudited).

	Defined Benefit Plans		Other Postretirement Benefit Plans	
	2011	2010	2011	2010
Additional Information				
Change in funded status included in accumulated other comprehensive loss, net of tax	<u>\$(13,799)</u>	<u>\$(3,609)</u>	N/A	N/A

Assumptions

Weighted-average assumptions used to determine benefit obligations at December 31 are as follows:

	Defined Benefit Plans		Other Postretirement Benefit Plans	
	2011	2010	2011	2010
Discount rate	4.49%	5.16%	3.50%	4.50%
Rate of compensation increase	3.61	3.78	—	—

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Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31 are as follows:

	Defined Benefit Plans		Other Postretirement Benefit Plans	
	2011	2010	2011	2010
Discount rate	5.16%	5.57%	4.50%	5.00%
Expected long-term return on plan assets	7.14	7.16	—	—
Rate of compensation increase	3.78	3.81	—	—

Plan Assets

The percentage of fair value of total plan assets for funded plans are invested as follows:

Asset Category	Plan Assets at December 31,	
	2011	2010
Marketable equities	61%	65%
Fixed income securities	39	35
Total	100%	100%

The Company's plan assets are invested in the U.S., the United Kingdom ("UK") and Canada. Plan asset investments are accounted for at cost on the trade date and are reported at fair value. Canadian plan assets totaling \$19,245 are classified as Level 2 within the fair value hierarchy. Certain U.S. plan assets totaling \$2,813 are classified as Level 3 within the fair value hierarchy, since the Company does not have the ability to redeem at net asset value for a period longer than one quarter following the measurement date. All other plan assets totaling \$50,419 are classified as Level 1. In general, plan assets are exposed to various risks, such as interest rate risk, credit risk, and overall market volatility. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of investments will occur in the near term and that such changes could materially affect the amounts reported in the plan assets. The investment objective of the plans is to maximize the return on plan assets over a long time horizon, while meeting the plan obligations. Investment risk is substantially reduced by diversification of investments within particular asset classes. The expected future rate of return on plan assets is based on historic performance of bonds and equities and the higher returns expected by equity-based capital relative to debt capital. The agreements with the fund managers include a number of restrictions which are designed to ensure that only suitable investments are held. Generally, investment performance is provided to and reviewed by the Company on a quarterly basis. If any changes take place in the legal, regulatory or tax environment which impact the investment of the portfolios or the investment returns, the fund manager is expected to notify the Company immediately and to advise on their anticipated impact.

Details relating to the Company's plan assets are as follows:

U.S. Plan Assets: Approximately 83% of the Company's U.S. plan assets are invested in the U.S., of which 54% are invested in marketable equity securities and 46% are invested in fixed income securities managed by the fund manager. This allocation is in accordance with the strategic allocation adopted by the Company's pension committee comprising of approximately 60% equity investment and 40% bond investment.

UK Plan Assets: Approximately 65% of the Company's UK plan assets are invested in the UK, of which 35% are invested in marketable equity securities and 65% are invested in fixed income securities managed by the

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fund manager. The trustees of the UK pension plan have adopted a strategic allocation comprising of 60% equity investment and 40% bond investment. The allocation of equity investments between UK domestic and UK foreign equities is 40% and 60%, respectively and the fixed income bond investment is allocated equally between government and corporate bonds in the UK. Investment risk is substantially reduced by diversification of investments and accordingly, assets are invested 57% in the fund manager's Global Equity Index Fund, 22% in the Over 15 Year Gilts Index Fund and 21% in the AAA-AA-A Bonds Over 15 Year Index Fund. The majority of the plan liabilities are linked to price and salary inflation. The policy is therefore to invest the majority of the assets in investments which are expected to exceed price inflation and general salary growth over long periods.

Canadian Plan Assets: Approximately 64% of the Company's Canadian plan assets are invested in Canada, of which 68% are invested in marketable equity securities and 32% are invested in fixed income securities managed by the fund manager. The Company's pension committee has adopted a strategic allocation comprising of approximately 65% equity investment and 35% bond investment. The target allocation of equity investments between Canadian domestic and Canadian foreign equities is approximately 50% each. As of December 31, 2011, assets were invested 85% in the fund manager's Balanced Pension Trust Series O and 15% in the U.S. Pooled Pension Fund Series O. Investments are made with due consideration for the overall funds' risk and expected return.

Contributions

The Company expects to make contributions and direct benefit payments of approximately \$9,222 (unaudited) under its defined benefit plans in 2012.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	<u>Defined Benefit Plans</u>	<u>Other Postretirement Benefit Plans</u>
2012	\$ 6,762	\$ 60
2013	6,551	58
2014	6,724	56
2015	7,177	54
2016	7,686	52
Years 2017–2021	44,711	217

The Company also maintains a funded retirement savings plan for U.S. employees which is qualified under Section 401(k) of the U.S. Internal Revenue Code. During 2008, the plan allowed eligible employees to contribute up to 15% of their compensation (plus catch-up contributions for participants over age 50), with the Company matching 100% of up to the first 4% of employee compensation. The Company suspended the matching contribution in February 2009 but for 2010 removed the suspension and enhanced the match to 200% of the first 1% of employee compensation and 100% of the next 4% of employee compensation. Costs associated with the Plan are charged to the consolidated statements of operations and amounted to \$1,721, \$1,656 and \$256 for the years ended December 31, 2011, 2010 and 2009, respectively.

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11. Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss are as follows:

	Foreign Currency Translation Adjustment	Pension Liability Changes Under Topic 715	Change in Value of Derivative Instruments	Accumulated Other Comprehensive Income Gain (Loss)
Balance at December 31, 2008	\$ 5,891	\$(21,531)	\$(13,859)	\$(29,499)
Current year change	16,488	(2,244)	4,138	18,382
Balance at December 31, 2009	22,379	(23,775)	(9,721)	(11,117)
Current year change	2,628	(3,609)	9,721	8,740
Balance at December 31, 2010	25,007	(27,384)	—	(2,377)
Current year change	(14,850)	(13,799)	(520)	(29,169)
Balance at December 31, 2011	<u>\$ 10,157</u>	<u>\$(41,183)</u>	<u>\$ (520)</u>	<u>\$(31,546)</u>

Comprehensive loss for years ended December 31, 2011, 2010 and 2009 is as follows:

	2011	2010	2009
Net income (loss)	\$ 8,190	\$(73,086)	\$(111,993)
Foreign currency translation adjustments	(14,850)	2,628	16,488
Pension liability changes under Topic 715	(13,799)	(3,609)	(2,244)
Change in value of derivative instruments	(520)	9,721	4,138
Comprehensive loss	<u>\$(20,979)</u>	<u>\$(64,346)</u>	<u>\$ (93,611)</u>

12. Commitments and Contingencies

Leases

The Company leases office buildings, vehicles, and computer equipment for its worldwide operations. Minimum rent is expensed on a straight-line basis over the term of the leases. Operating lease rental expense was \$5,622, \$5,122 and \$6,053 during the years ended December 31, 2011, 2010 and 2009, respectively.

These leases expire at various dates through 2023. At December 31, 2011, future minimum rental payments due under non-cancelable leases were as follows:

2012	\$ 5,345
2013	4,459
2014	3,501
2015	2,990
2016	2,766
Thereafter	5,147
Total minimum operating lease payments	<u>\$24,208</u>

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Collective Bargaining and Union Agreements

Approximately 68% of the Company's employees are either subject to various collective bargaining agreements or are members of trade unions, employee associations or workers councils predominantly outside of the United States. Approximately 9% of those employees subject to collaborative bargaining agreements, or 1% of the Company's total employees, are covered by agreements that are set to expire during 2012.

Legal Proceedings

The Company and its subsidiaries are involved in various legal matters, which have arisen in the ordinary course of business as a result of various labor claims, taxing authority reviews and other legal matters. As of December 31, 2011, the Company had accrued an immaterial amount in its financial statements for these matters for which (1) management believed the possibility of loss was either probable or possible, and (2) was able to estimate the damages. These estimates have been developed in consultation with counsel and are based upon an analysis of potential results, assuming a combination of litigation and settlement strategies. It is possible, however, that future results of operations for any particular period could be materially affected by changes in the Company's assumptions or the effectiveness of our strategies related to these proceedings. See Note 9 for a discussion of the governmental proceeding of Xerium Brazil before the FRD.

Environmental Matters

The Company's operations and facilities are subject to a number of national, state and local laws and regulations protecting the environment and human health in the United States and foreign countries that govern, among other things, the handling, storage and disposal of hazardous materials, discharges of pollutants into the air and water and workplace safety. Because of the Company's operations, the history of industrial uses at some of these facilities, the operations of predecessor owners or operators of some of the businesses, and the use and release of hazardous substances at these sites, the liability provisions of environmental laws may affect the Company. The Company is not aware of any material unasserted claims and any potential material liability from those claims.

The Company believes that any additional liability in excess of amounts provided which may result from the resolution of such matters will not have a material adverse effect on the financial condition, liquidity or cash flow of the Company.

Other Contingencies

On December 9, 2011, the Company entered into an amendment to the employment agreement with Stephen Light, our President and CEO, to promote continuity during a period of succession leading to Mr. Light's anticipated retirement. The amendment to Mr. Light's employment agreement provided that we would pay Mr. Light a \$2.2 million cash payment at the transition date, which is deemed to be December 31, 2012 at this time. This amount will be accrued throughout the remainder of his service with the Company.

13. Stock-Based Compensation and Stockholders' Equity (Deficit)

As discussed in Note 1, in 2010, the Company had an effective 20 to 1 reverse split of its Old Common Stock; accordingly the effect of the split has been reflected retroactively for all periods presented.

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The Company records stock-based compensation expense in accordance with Topic 718 and uses the straight-line attribution method to recognize expense for time-based RSUs. The Company recorded stock-based compensation expense during the three years ended December 31, 2011, 2010 and 2009 as follows:

	For the Years ended December 31,		
	2011	2010	2009
RSU and DSU Awards (1)	\$1,091	\$4,018	\$2,305
Management Incentive/Performance Award Programs (2)	348	2,467	—
Stock Awards (3)	—	825	94
Total	<u>\$1,439</u>	<u>\$7,310</u>	<u>\$2,399</u>

- (1) Related to restricted stock units awarded in and prior to 2011 and deferred stock units awarded to certain non-employee directors in and prior to 2011. See further discussion below.
- (2) For 2011 and 2010, the amount represents the estimated value of stock awards to be made under the 2011 Management Incentive Compensation Program (the “2011 MIC”) and the 2010 Management Incentive Compensation Program (the “2010 MIC”), which was approved by the Company’s Board of Directors in March of 2011 and September of 2010, respectively. See further discussion below. For 2009, no amounts were expensed related to the 2009 Performance Award Program, which was approved by the Company’s Board of Directors on March 10, 2009, as the underlying targets for 2009 were not achieved.
- (3) For 2010, amount represents a total of 39,764 shares of common stock that were sold to Mr. Stephen Light, the Company’s Chairman, President and Chief Executive Officer on January 5, 2010. See further discussion below.

The related tax impact on stock-based compensation was a tax benefit of \$84, \$232 and \$118 for the years ended December 31, 2011, 2010 and 2009.

2010 Equity Incentive Plan

Pursuant to the Plan as discussed in Note 1, the Company adopted the 2010 Equity Incentive Plan (the “2010 Plan”) on the Effective Date. The 2010 Plan provides for the grant of awards consisting of any or a combination of stock options, stock appreciation rights, restricted stock, unrestricted stock or stock unit awards.

Shares Reserved for Awards

The maximum number of shares that may be delivered under or in satisfaction of awards under the 2010 Plan is 913,525 shares of New Common Stock, provided, however, that to the extent that equity incentive awards granted prior to the Effective Date pursuant to the Company’s 2005 Equity Incentive Plan, as amended (the “2005 Plan”), or employment agreements with the Company’s senior management did not or do not vest on or after the Effective Date in accordance with their terms, the number of shares of New Common Stock reserved pursuant to the Plan with respect to such unvested awards shall be added to the number of shares of New Common Stock that may be delivered under the 2010 Plan. The number of shares deliverable under the 2010 Plan is subject to adjustment in the case of stock dividends and other transactions affecting the New Common Stock.

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Summary of Activity Under the 2010 Plan:

Long-Term Incentive Program—2011 LTIP

On March 15, 2011, the Board approved the Company's 2011-2013 Long-Term Incentive Plan (the "2011 LTIP") under the 2010 Plan. Awards under the 2011 LTIP are both time-based and performance-based. Awards will be paid in the form of restricted stock units or shares of common stock of the Company, as described below. Time-based awards under the 2011 LTIP were approved in the form of 9,252 time-based restricted stock units granted on March 15, 2011 under the Company's 2010 Plan. These time-based restricted stock units will vest in equal installments on March 31, 2012, 2013 and 2014, and will be converted into shares of common stock as they vest. Performance-based awards under the 2011 LTIP were approved in the form of 17,183 performance-based restricted stock units and will vest (a) if the participant remains continuously employed with the Company through December 31, 2013 and (b) on a sliding scale ranging from 0% to 110% if the Company's results fall between 80.1% and 110% of the specified three-year cumulative Adjusted EBITDA target as adjusted to reflect currency exchange rate fluctuations relative to the U.S. Dollar. Vested stock units will convert into shares of the Company's common stock after the close of the three-year performance period ended December 31, 2013.

Long-Term Incentive Program—2010 LTIP

On September 22, 2010, the Board approved the Company's 2010-2012 Long-Term Incentive Plan (the "2010 LTIP") under the 2010 Plan. Awards under the 2010 LTIP are both time-based and performance-based. Awards are paid in the form of restricted stock units or shares of common stock of the Company, as described below. Time-based awards under the 2010 LTIP were approved in the form of 122,260 time-based restricted stock units granted on October 29, 2010 under the Company's 2010 Plan. On March 31, 2011, 43,651 time-based restricted stock units vested in accordance with the 2010 LTIP and were converted to common stock, with the remaining 78,609 time-based restricted stock units to vest in equal installments on March 31, 2012 and March 31, 2013. These will be converted into shares of common stock as they vest. Performance-based awards under the 2010 LTIP will vest (a) if the participant remains continuously employed with the Company through December 31, 2012 and (b) on a sliding scale ranging from 0% to 110% if the Company's results fall between 80.1% and 110% of the specified three-year cumulative Adjusted EBITDA target as adjusted to reflect currency exchange rate fluctuations relative to the U.S. Dollar. Vested stock units will convert into shares of the Company's common stock after the close of the three-year performance period ended December 31, 2012.

2011 MIC

On March 15, 2011, the Board approved the 2011 Management Incentive Plan ("2011 MIC"). Under the 2011 MIC, eighty percent of the payouts are determined by the Company's performance against a specified Adjusted EBITDA metric for the 2011 fiscal year. The Adjusted EBITDA metric was adjusted to reflect currency fluctuations relative to the U.S. Dollar. The remaining twenty percent of the payouts are based on specified net sales targets, and are adjusted to reflect currency fluctuations relative to the U. S. Dollar. The 2011 MIC awards will be paid out based on a sliding scale ranging from 35% if the metric is achieved at 95% of target up to 200% if the metric is achieved at 120% of target. Fifty percent of any 2011 MIC award earned will be paid in cash and fifty percent is expected to be paid in the form of common stock based on an average per-share price within a collar. At December 31, 2011, management determined that the performance against the specified Adjusted EBITDA target as adjusted to reflect currency exchange rate fluctuations relative to the U.S. Dollar was partially met, and recorded approximately \$0.7 million compensation expense, of which \$0.35 million is included in accrued liabilities and \$0.35 million is included in additional paid in capital in the Consolidated Balance Sheet at December 31, 2011.

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2010 MIC

On September 22, 2010 the Board approved an amendment and restatement of the Company's Performance Award Program for 2010 ("2010 MIC"). Under the amended plan, payouts are determined by the Company's performance against a specified Adjusted EBITDA metric for the 2010 fiscal year. Fifty percent (50%) of any 2010 MIC award earned was paid in cash and 50% was paid in the form of RSUs under the Company's 2010 Plan based on an average per-share price within a collar. The 2010 MIC awards were paid out based on a sliding scale ranging from 35% if the metric was achieved at 95% of target up to 200% if the metric was achieved at 125% of target. The Adjusted EBITDA metric was adjusted to reflect currency fluctuations relative to the U.S. Dollar. The awards were fully vested at the grant date and were payable in common stock 90 days later. At December 31, 2010, management determined that the performance against the specified Adjusted EBITDA target as adjusted to reflect currency exchange rate fluctuations relative to the U.S. Dollar was met, and recorded approximately \$5.0 million compensation expense, of which \$2.5 million is included in accrued liabilities and \$2.5 million is included in additional paid in capital in the Consolidated Balance Sheet at December 31, 2010. In accordance with the 2010 MIC agreement, the Company issued 111,118 shares of common stock, net of withholdings, in the second quarter of 2011.

Directors' Deferred Stock Unit Plan

On March 15, 2011, the Board approved a new compensation plan for non-management directors (the "2011 DSU Plan"). Under this plan, each director is to receive an annual retainer of \$112, to be paid on a quarterly basis in arrears beginning with the quarter ended June 30, 2011. Half of the annual retainer is payable in deferred stock units ("DSUs"), with the remaining half payable in cash. The non-management directors were awarded an aggregate 30,435 DSUs under the 2011 DSU Plan for service during the year ended December 31, 2011. In addition, in accordance with the 2011 DSU Plan, 19,449 DSUs were settled in Common Stock during the year ended December 31, 2011.

Warrants

In connection with the Company's reorganization in 2010, the holders of the Company's Old Common Stock also received warrants to purchase an aggregate of 1,662,350 shares of New Common Stock (the "Warrants"), representing approximately 0.0324108 Warrants for each share of Old Common Stock. The Warrants are exercisable for a term of four years from the issue date at an exercise price of \$19.55 per share of New Common Stock. The exercise price was determined in accordance with a formula based on the final amount of allowed claims of the Lenders.

Performance-based RSU Awards

On December 24, 2009, the Compensation Committee of the Company's Board of Directors approved an amendment to the terms of all performance-based restricted stock units of the Company outstanding on December 24, 2009. The amendment provided that upon completion of a successful debt restructuring of the Company, as defined, which constituted a new performance criterion, such performance-based restricted stock units would vest and settle in full. The Compensation Committee determined that this new performance criterion

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would be met and vesting would occur on the date the Plan was confirmed by the Bankruptcy Court (the “Confirmation Date”). The Confirmation Date occurred on May 12, 2010 and 43,854 shares of common stock underlying 71,571 performance-based RSUs were issued on that date; the remaining 27,717 shares underlying such RSUs were withheld from issuance in connection with tax withholding requirements related to the issuance of such shares to the recipients. This modification had no material impact on the Company’s stock based compensation expense for 2009. In 2010, however, the Company recorded stock based compensation of approximately \$1,741 related to this modification.

On December 31, 2009, the Company entered into an amendment to the employment agreement with Mr. Light as the per-participant, per-year limitations under the Company’s 2005 Plan prevented the Company from fulfilling its contractual obligation and granting to Mr. Light stock units under the Company’s equity incentive plan with an aggregate value of \$1,250 on January 1, 2010. The amendment to Mr. Light’s employment agreement provided that in lieu of granting him such restricted stock units, the Company instead would (i) grant to Mr. Light 25,000 performance-based restricted stock units on January 1, 2010, which vest annually over a three-year period if the price of the Company’s common stock meets or exceeds certain price targets approved by the Compensation Committee of the Company’s Board of Directors; and (ii) make a cash payment to Mr. Light of \$825 which Mr. Light was obligated to use the total amount of such cash payment, less the amount necessary to satisfy tax obligations with respect to the cash payment, to purchase shares of common stock from the Company at its agreed fair value, based on the average per share closing price on the New York Stock Exchange of the Company’s shares of common stock for the 20 trading days prior to January 1, 2010. Accordingly, a total of 39,764 shares of common stock were sold to Mr. Light on January 5, 2010 for approximately \$531 in reliance upon the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended. On September 22, 2010, the Board approved an amendment to the terms of 25,000 restricted stock units previously granted to Mr. Light under the 2005 Plan on January 1, 2010. The terms of the amended award align with those of the LTIP awards described above, including that 35% of such award is a time-based award (8,750 RSUs) and the remainder is a performance-based award with the exception that no scale for performance above 100% is provided.

On December 9, 2011, the Company entered into an amendment to the employment agreement with Mr. Light, to promote continuity during a period of succession leading to Mr. Light’s anticipated retirement. The amendment to Mr. Light’s employment agreement provided that the vesting of 50,000 performance-based restricted stock units will be accelerated upon the transition date, as defined in the amendment at the earlier of the date the Board appoints a new Chief Executive Officer or December 15, 2012. As Mr. Light had 139,750 contingently issuable performance-based restricted stock units outstanding prior to this amendment, the Company, in accordance with the requirements of Topic 718 “*Share-based Compensation*”, treated the amendment as a modification of the existing performance-based restricted stock awards, and reversed \$730 of stock compensation that had already been expensed on these awards. The modified awards, which were valued at \$363 at the grant date, will be amortized to stock compensation expense over the remaining service period, which is deemed to be through December 15, 2012. In addition, the amendment provides for the granting of an option to purchase 40,000 shares of the Company’s common stock at a price equal to the greater of \$16 per share or the then fair market value of such shares, which option will be fully vested at the grant date and have a term of five years. The options were valued at \$215 at the grant date, and will be amortized to stock compensation expense over the remaining service period.

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Time-based RSU Awards

At various dates in 2009, the Company granted 55,674 time-based RSU awards to certain employees, specifically 47,348 and 5,625 RSUs to its chief executive officer and chief financial officer, respectively. Such awards vest in nearly equal installments on certain dates as described in the table below. The time based restricted stock units may also vest, in whole or in part, in connection with a change in control (as defined in the awards) and/or termination of employment under the circumstances set forth in the restricted stock unit awards.

Certain time-based RSUs and all non-employee director RSUs automatically adjust to reflect awards of additional RSUs upon payment of dividends by the Company. Outstanding RSUs that were awarded in connection with the payment of dividends are included in the table below. No RSUs were awarded in connection with the payment of dividends since 2007 as no dividends were paid by the Company after 2007 because the Company's senior credit facility in effect at that time precluded the payment of dividends. The Credit Facility continues to generally prohibit the payment of dividends.

During the first quarter of 2010, 18,707 shares of common stock underlying 28,808 time-based RSUs were issued; the remaining 10,101 shares underlying the RSUs were withheld from issuance in connection with tax withholding requirements related to the issuance of such shares to the recipients.

In March 2010, the Board approved the contingent acceleration of all outstanding time-based awards and non-employee director awards (for departing directors) scheduled to vest on or prior to September 30, 2010 so that they will be vested and settled immediately prior to the record date under the Plan, which was the day before the Effective Date. Accordingly, on May 24, 2010, 16,880 shares of common stock underlying 18,732 RSUs were issued; the remaining 1,852 shares underlying the RSUs were withheld from issuance in connection with minimum tax withholding requirements related to the issuance of such shares to the recipients.

A summary of RSUs outstanding as of December 31, 2011 and their vesting dates is as follows.

	<u>Vesting Dates</u>	<u>Number of RSUs</u>
Time-based RSUs granted during various dates in 2009	April 30, 2012	250
Time-based RSUs granted during 2010	Annually in equal installments March 31, 2012 and March 10, 2013	87,462
Performance-based RSUs granted during 2010	December 31, 2012	104,083
Time-based RSUs granted during 2011	Annually in equal installments March 31, 2012, March 31, 2013 and March 31, 2014	9,147
Performance-based RSUs granted during 2011	December 31, 2013	16,988
Non-employee directors' RSUs	Immediately vested on grant dates	24,415
Time-based RSUs granted during 2011	December 15, 2012	50,000
		<u>292,345</u>

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RSU activity during years ended December 31, 2009, 2010 and 2011, are presented below.

	<u>Number of RSUs</u>	<u>Price Range of Grant- Date Fair Value Per RSU</u>	<u>Weighted Average Grant-Date Fair Value Price Per RSU</u>
Outstanding, December 31, 2008	67,929	\$ 75.40 – 240.20	\$150.00
Granted	129,180	10.80 – 33.00	26.40
Forfeited	(23,603)	102.40 – 233.20	193.00
Issued or withheld for tax withholding purposes	(6,035)	77.80 – 108.00	104.20
Outstanding, December 31, 2009	167,471	10.80 – 240.20	50.20
Granted	409,872	12.60 – 15.95	12.97
Forfeited	(33,158)	12.60 – 163.00	29.40
Issued or withheld for tax withholding purposes	(119,176)	10.40 – 240.20	50.54
Outstanding, December 31, 2010	425,009	10.40 – 240.20	15.74
Granted	106,570	6.89 – 24.05	12.06
Forfeited	(139,750)	12.93	12.93
Issued or withheld for tax withholding purposes	(99,484)	6.89 – 108.00	23.16
Outstanding, December 31, 2011	292,345	\$ 7.25 – 21.69	\$ 13.04
Exercisable, December 31, 2011 (1)	20,859	\$ 6.89 – 24.05	\$ 14.21

- (1) Exercisable at December 31, 2011 consisted of non-employee director DSUs. The total grant-date fair value of such non-employee director DSUs that vested during the year ended December 31, 2011 was \$200.

Assumptions

In accordance with Topic 718, the Company uses the following assumptions in determining compensation expense:

Grant-Date Fair Value

The Company calculates the grant-date fair value of time-based RSUs, performance-based RSUs and non-employee directors' RSUs based on the closing price of the Company's common stock on the date of grant.

For performance-based RSUs granted on January 1, 2010, which were amended on September 22, 2010 and the time-based RSU's granted on September 22, 2010, as previously discussed, the Company calculated the grant-date fair value of the original RSUs granted on January 1, 2010 by using a Monte Carlo pricing model and the following assumptions:

Expected term (i)	3 years
Expected volatility (ii)	120%
Expected dividends (iii)	None
Risk-free interest rate (iv)	1.75%

- (i) *Expected term.* Performance-based RSUs expire three years after the grant date.

XERIUM TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(dollars in thousands except per share data)

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- (ii) *Expected volatility.* The Company is responsible for estimating the volatility of the price of its common stock and has considered a number of factors, including third party estimates, to determine its expected volatility. For these awards, after being a public company for more than four years, the Company determined to use its own historical volatility rather than a peer group analysis. The volatility for the 2010 award was 120%.
- (iii) *Expected dividends.* No dividends were declared by the Company after 2007 because the Company's senior credit facility at that time precluded the payment of dividends. The Credit Facility continues to generally prohibit the payment of dividends.
- (iv) *Risk-free interest rate.* The yield on zero-coupon U.S. Treasury securities for the period that is commensurate with the expected term assumptions.

For the Warrants issued on the Effective Date, the Company calculated the grant-date fair value by using a Black-Scholes option pricing model and the following assumptions. The Warrants are not considered stock-based compensation and their issuance has been recorded as a memorandum entry only.

Expected term (i)	4 years
Expected volatility (ii)	75%
Expected dividends (iii)	None
Risk-free interest rate (iv)	1.65%

- (i) *Expected term.* Warrants expire four years after the grant date.
- (ii) *Expected volatility.* The Company is responsible for estimating the volatility of the price of its common stock and has considered a number of factors, including third party estimates, to determine its expected volatility. For these awards, after being a public company for five years, the Company determined to use a blend of its own five-year historical volatility and that of its peer group, which resulted in volatility of 75%.
- (iii) *Expected dividends.* No dividends were declared by the Company after 2007 because the Company's senior credit facility at that time precluded the payment of dividends. The Credit Facility continues to generally prohibit the payment of dividends.
- (iv) *Risk-free interest rate.* The yield on zero-coupon U.S. Treasury securities for the period that is commensurate with the expected term assumptions.

Forfeitures

As the time-based and performance-based RSUs require continued employment or service up to the time of vesting, the amount of stock-based compensation recognized during a period is required to include an estimate of forfeitures. No estimate of forfeitures has been made for RSUs and DSU's awarded to non-employee directors because they vest immediately upon grant. Topic 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term "forfeitures" is related to employee attrition and based on a historical analysis of its employee turnover. This analysis is re-evaluated quarterly and the forfeiture rate will be adjusted as necessary. Ultimately, the actual expense recognized over the vesting period will be only for those shares that meet the requirements of continued employment up to the time of vesting. As of December 31, 2011, the forfeiture rates for the 2010 and 2011 LTIP plans are estimated at 10%. In accordance with Topic 718, the cumulative effect of applying the change in estimate retrospectively is recognized in the period of change. During 2011, the Company did not change its forfeiture rate estimates, therefore no cumulative adjustment was made.

XERIUM TECHNOLOGIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(dollars in thousands except per share data)

December 31, 2011

As of December 31, 2011, there was approximately \$1,600 of total unrecognized compensation expense related to unvested share-based awards which is expected to be recognized over a weighted average period of 1.26 years.

The Company's Credit Facility generally prohibits our payment of dividends and accordingly, no such payments were made during the years ended December 31, 2011 and 2010.

14. Restructuring and Impairments Expense

Restructuring and impairments expense included in the Company's statements of operations are the result of its long-term strategy to reduce production costs and improve long-term competitiveness. Restructuring and impairments expense consists principally of severance costs related to reductions in work force and of facility costs and impairments of assets principally related to closing facilities and/or shifting production from one facility to another. Impairment amounts for assets held for sale reflect estimated selling prices less costs to sell and are considered to be a Level 1 within the fair value hierarchy. Facility costs are principally comprised of costs to relocate assets to the Company's other facilities, operating lease termination costs and other associated costs.

During 2011, the Company incurred \$1,589 for restructuring and impairment related expense, of which \$368 and \$1,221 were in the clothing and rolls segments, respectively. This amount includes costs resultant from its long-term strategy to reduce production costs and improve long-term competitiveness as described above under "Management's Discussion and Analysis of Financial Condition and Results of Operations—Cost Reduction Programs" by closing and/or transferring production from certain of our manufacturing facilities and through headcount reductions.

During 2010, the Company incurred \$10,004 for restructuring and impairment related expense in the clothing, rolls and corporate segments of \$4,351, \$4,109 and \$1,543, respectively. This amount included approximately \$2,400 related to the Company's Vietnam clothing facility including \$2,100 as an impairment, approximately \$1,800 related to the Company's closure of its Stowe Woodward roll covers facility in North Bay, Ontario including approximately \$700 as an impairment, approximately \$1,500 related to the closure of the Company's Massachusetts corporate operations, the closure of a rolls plant in Germany and approximately \$4,700 related to our continuation of the streamlining of the Company's operations.

During 2009, the Company incurred \$4,080 for restructuring and impairments-related expense in the clothing, rolls and corporate segments of \$1,233, \$1,662 and \$1,185, respectively. During 2009, the Company continued its program of streamlining its operating structure and incurred restructuring expenses of approximately \$3,600 in connection therewith, which was partially reduced by a gain on the sale of its rolls manufacturing facility in Sweden (closed in 2008) of approximately \$1,200. The Company also impaired \$1,669 of long-term assets at various locations around the world.

The Company expects to continue to review its business to determine if additional actions can be taken to further improve its cost structure. Restructuring expenses of approximately \$5,000 to \$10,000 are estimated during 2012, primarily related to a continuation of streamlining the operating structure of the Company. Actual restructuring costs for 2012 may substantially differ from estimates at this time, depending on actual operating results in 2012 and the timing of the restructuring activities.

XERIUM TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(dollars in thousands except per share data)

December 31, 2011

The table below sets forth the significant components and activity in the restructuring program and asset impairments during 2011:

	<u>Balance at December 31, 2010</u>	<u>Charges (1)</u>	<u>Write-offs</u>	<u>Currency Effects</u>	<u>Cash Payments</u>	<u>Balance at December 31 2011</u>
Severance	\$2,255	\$ 482	\$—	\$ (74)	\$(1,863)	\$ 800
Facility costs and other	471	705	—	50	(774)	452
Asset impairments	—	—	—	—	—	—
Total	<u>\$2,726</u>	<u>\$1,187</u>	<u>\$—</u>	<u>\$ (24)</u>	<u>\$(2,637)</u>	<u>\$1,252</u>

(1) Excludes a non-cash charge of \$402 at December 31, 2011.

The table below sets forth the significant components and activity in the restructuring program and asset impairments during 2010:

	<u>Balance at December 31, 2009</u>	<u>Charges</u>	<u>Write-offs</u>	<u>Currency Effects</u>	<u>Cash Payments</u>	<u>Balance at December 31 2010</u>
Severance	\$ 536	\$ 4,663	\$ —	\$ (49)	\$(2,895)	\$2,255
Facility costs and other	1,478	2,451	—	(57)	(3,401)	471
Asset impairments	—	2,890	(2,890)	—	—	—
Total	<u>\$2,014</u>	<u>\$10,004</u>	<u>\$(2,890)</u>	<u>\$(106)</u>	<u>\$(6,296)</u>	<u>\$2,726</u>

The table below sets forth the significant components and activity in the restructuring program and asset impairments during 2009:

	<u>Balance at December 31, 2008</u>	<u>Charges</u>	<u>Write-offs</u>	<u>Currency Effects</u>	<u>Cash Payments</u>	<u>Balance at December 31 2009</u>
Severance	\$5,422	\$3,129	\$ —	\$143	\$(8,158)	\$ 536
Facility costs and other	2,455	(718)	—	117	(376)	1,478
Asset impairments	—	1,669	(1,669)	—	—	—
Total	<u>\$7,877</u>	<u>\$4,080</u>	<u>\$(1,669)</u>	<u>\$260</u>	<u>\$(8,534)</u>	<u>\$2,014</u>

15. Business Segment and Geographic Region Information

The Company is a global manufacturer and supplier of consumable products primarily used in the production of paper, and is organized into two reportable segments: clothing and roll covers. The clothing segment represents the manufacture and sale of synthetic textile belts used to transport paper along the length of papermaking machines. The roll covers segment primarily represents the manufacture and refurbishment of covers used on the steel rolls of a papermaking machine. The Company manages each of these operating segments separately.

XERIUM TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(dollars in thousands except per share data)

December 31, 2011

Management evaluates segment performance based on earnings before interest, taxes, depreciation and amortization before allocation of corporate charges. Such measure is then adjusted to exclude items that are of an unusual nature and are not used in measuring segment performance or are not segment specific (“Segment Earnings (Loss)”). The accounting policies of these segments are the same as those described in Accounting Policies in Note 2. Inter-segment net sales and inter-segment eliminations are not material for any of the periods presented.

The corporate column consists of the Company’s headquarters, related assets and expenses that are not allocable to reportable segments. Significant corporate assets include cash, investments in subsidiaries and deferred financing costs. Corporate depreciation and amortization consists primarily of deferred financing costs. Corporate segment earnings (loss) consists of general and administrative expenses. The eliminations column represents eliminations of investments in subsidiaries.

Summarized financial information for the Company’s reportable segments is presented in the tables that follow for each of the three years in the period ended December 31, 2011.

	<u>Clothing</u>	<u>Roll Covers</u>	<u>Corporate</u>	<u>Eliminations</u>	<u>Total</u>
2011					
Net sales	\$386,433	\$200,527	\$ —	\$ —	\$586,960
Depreciation and amortization (1)	32,575	10,877	234	—	43,686
Segment Earnings (Loss)	79,458	40,327	(12,126)	—	
Total assets	499,338	228,014	730,269	(791,900)	665,721
Capital expenditures	21,530	8,172	452	—	30,154
2010					
Net sales	\$359,686	\$188,648	\$ —	\$ —	\$548,334
Depreciation and amortization (1)	30,188	10,771	322	—	41,281
Segment Earnings (Loss)	83,235	42,881	(10,666)	—	
Total assets	514,380	233,410	706,503	(764,351)	689,942
Capital expenditures	21,919	5,756	253	—	27,928
2009					
Net sales	\$331,398	\$168,693	\$ —	\$ —	\$500,091
Depreciation and amortization (1)	29,432	12,137	298	—	41,867
Segment Earnings (Loss)	80,305	36,677	(20,506)	—	
Total assets	542,616	240,863	696,464	(786,432)	693,511
Capital expenditures	16,321	2,557	654	—	19,532

(1) Depreciation and amortization excludes amortization of financing costs of \$2,307, \$5,950, and \$5,417 for 2011, 2010 and 2009, respectively.

XERIUM TECHNOLOGIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(dollars in thousands except per share data)
December 31, 2011

Provided below is a reconciliation of Segment Earnings (Loss) to income before provision for income taxes for each of the three years in the period ended December 31, 2011:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Segment Earnings (Loss):			
Clothing	\$ 79,458	\$ 83,235	\$ 80,305
Roll Covers	40,327	42,881	36,677
Corporate	(12,126)	(10,666)	(20,506)
Non-cash compensation and related expenses	(1,439)	(7,310)	(2,305)
Net interest expense	(39,150)	(56,795)	(67,300)
Depreciation and amortization (2)	(43,686)	(41,281)	(41,867)
Restructuring and impairments expenses	(1,589)	(10,004)	(4,080)
Financial restructuring costs included in general and administrative expense	—	(9,923)	—
Loss on debt extinguishment	(2,926)	—	—
Goodwill impairment	—	—	(80,600)
Income (loss) before reorganization items and provision for income taxes	<u>\$ 18,869</u>	<u>\$ (9,863)</u>	<u>\$(99,676)</u>

(2) Excludes amortization of deferred finance costs that are charged to interest expense.

Information concerning principal geographic areas is set forth below. Net sales amounts are by geographic area of product destination. Net sales amounts are for the years ended December 31, 2011, 2010 and 2009 and property, plant and equipment amounts are as of December 31, 2011, 2010 and 2009.

	<u>North America</u>	<u>Europe</u>	<u>Asia- Pacific</u>	<u>Other</u>	<u>Total</u>
2011					
Net sales	\$210,644	\$197,006	\$112,809	\$66,501	\$586,960
Property, plant and equipment	102,754	136,579	32,827	63,096	335,256
2010					
Net sales	\$197,805	\$188,723	\$ 95,056	\$66,750	\$548,334
Property, plant and equipment	108,322	148,051	38,961	65,936	361,270
2009					
Net sales	\$175,457	\$206,969	\$ 67,752	\$49,913	\$500,091
Property, plant and equipment	112,137	167,251	46,033	60,128	385,549

16. Supplemental Guarantor Financial Information

On May 26, 2011, the Company closed on the sale of \$240.0 million of 8.875% Senior Notes due in 2018 (the "Notes"). The Notes are unsecured obligations of the Company and are fully and unconditionally guaranteed on a senior unsecured basis by all of the domestic wholly owned subsidiaries of the Company (the "Guarantors"). In accordance with Rule 3-10 of Regulation S-X promulgated under the Securities Act of 1933, the following condensed consolidating financial statements present the financial position, results of operations and cash flows of Xerium Technologies, Inc. (referred to as "Parent" for the purpose of this note only) on a stand-alone parent-only basis, the Guarantors on a Guarantors-only basis, the combined non-Guarantor subsidiaries and elimination entries necessary to arrive at the information for the Parent, the Guarantors and non-Guarantors subsidiaries on a consolidated basis.

Xerium Technologies Inc.
Condensed Consolidating Statement of Operation
For the year ended December 31, 2011
(Dollars in thousands)

	<u>Parent</u>	<u>Total Guarantors</u>	<u>Total Non Guarantors</u>	<u>Other Eliminations</u>	<u>The Company</u>
Net sales	\$ —	\$180,973	\$455,339	\$(49,352)	\$586,960
Costs and expenses:					
Cost of products sold	(2,384)	128,567	293,830	(49,259)	370,754
Selling	53	22,879	56,475	—	79,407
General and administrative	7,354	7,603	47,055	—	62,012
Restructuring and impairments	(72)	907	754	—	1,589
Research and development	(3)	8,565	3,535	—	12,097
	<u>4,948</u>	<u>168,521</u>	<u>401,649</u>	<u>(49,259)</u>	<u>525,859</u>
(Loss) income from operations	(4,948)	12,452	53,690	(93)	61,101
Interest expense, net	(24,594)	7,618	(22,174)	—	(39,150)
Loss on extinguishment of debt	(2,903)	(6)	(17)	—	(2,926)
Foreign exchange gain (loss)	582	(956)	218	—	(156)
Equity in subsidiaries income	39,422	18,395	—	(57,817)	—
Dividend income	<u>1,366</u>	<u>—</u>	<u>—</u>	<u>(1,366)</u>	<u>—</u>
Income (loss) before provision for income taxes ...	8,925	37,503	31,717	(59,276)	18,869
Provision for income taxes	<u>(735)</u>	<u>(203)</u>	<u>(9,741)</u>	<u>—</u>	<u>(10,679)</u>
Net income (loss)	<u>\$ 8,190</u>	<u>\$ 37,300</u>	<u>\$ 21,976</u>	<u>\$(59,276)</u>	<u>\$ 8,190</u>

Xerium Technologies Inc.
Condensed Consolidating Statement of Operation
For the year ended December 31, 2010
(Dollars in thousands)

	<u>Parent</u>	<u>Total Guarantors</u>	<u>Total Non Guarantors</u>	<u>Other Eliminations</u>	<u>The Company</u>
Net sales	\$ —	\$170,727	\$425,367	\$(47,760)	\$548,334
Costs and expenses:					
Cost of products sold	(2,213)	117,801	266,026	(47,656)	333,958
Selling	—	20,611	52,272	—	72,883
General and administrative	11,703	7,004	56,091	—	74,798
Restructuring and impairments	1,543	847	7,614	—	10,004
Research and development	(21)	8,774	2,674	—	11,427
	<u>11,012</u>	<u>155,037</u>	<u>384,677</u>	<u>(47,656)</u>	<u>503,070</u>
(Loss) income from operations	(11,012)	15,690	40,690	(104)	45,264
Interest expense, net	(33,942)	1,615	(24,468)	—	(56,795)
Foreign exchange gain (loss)	2,075	(1,124)	717	—	1,668
Equity in subsidiaries income (loss)	8,177	(4,666)	—	(3,511)	—
Dividend income	<u>1,517</u>	<u>8,294</u>	<u>—</u>	<u>(9,811)</u>	<u>—</u>
(Loss) income before reorganization expenses, provision for income taxes	(33,185)	19,809	16,939	(13,426)	(9,863)
Reorganization expenses	<u>(39,106)</u>	<u>(1,396)</u>	<u>(4,455)</u>	<u>—</u>	<u>(44,957)</u>
Loss (income) before provision for income taxes ..	(72,291)	18,413	12,484	(13,426)	(54,820)
Provision for income taxes	<u>(795)</u>	<u>(253)</u>	<u>(17,218)</u>	<u>—</u>	<u>(18,266)</u>
Net (loss) income	<u><u>\$(73,086)</u></u>	<u><u>\$ 18,160</u></u>	<u><u>\$ (4,734)</u></u>	<u><u>\$(13,426)</u></u>	<u><u>\$ (73,086)</u></u>

Xerium Technologies Inc.
Condensed Consolidating Statement of Operation
For the year ended December 31, 2009
(Dollars in thousands)

	<u>Parent</u>	<u>Total Guarantors</u>	<u>Total Non Guarantors</u>	<u>Other Eliminations</u>	<u>The Company</u>
Net sales	\$ —	\$153,259	\$390,163	\$(43,331)	\$ 500,091
Costs and expenses:					
Cost of products sold	(2,048)	106,006	251,929	(43,291)	312,596
Selling	—	17,914	48,894	—	66,808
General and administrative	14,866	5,784	35,519	—	56,169
Restructuring and impairments	1,185	814	2,081	—	4,080
Research and development	(51)	7,480	3,880	—	11,309
Goodwill impairment	—	23,431	57,169	—	80,600
	<u>13,952</u>	<u>161,429</u>	<u>399,472</u>	<u>(43,291)</u>	<u>531,562</u>
Loss from operations	(13,952)	(8,170)	(9,309)	(40)	(31,471)
Interest expense, net	(35,983)	(1,609)	(29,708)	—	(67,300)
Foreign exchange gain (loss)	3,025	(1,925)	(2,005)	—	(905)
Equity in subsidiaries (loss) income	(66,724)	(25,651)	—	92,375	—
Dividend income	<u>1,486</u>	<u>10,069</u>	<u>—</u>	<u>(11,555)</u>	<u>—</u>
(Loss) income before provision for income taxes	(112,148)	(27,286)	(41,022)	80,780	(99,676)
Benefit (provision) for income taxes	<u>155</u>	<u>(327)</u>	<u>(12,145)</u>	<u>—</u>	<u>(12,317)</u>
Net (loss) income	<u><u>\$(111,993)</u></u>	<u><u>\$ (27,613)</u></u>	<u><u>\$ (53,167)</u></u>	<u><u>\$ 80,780</u></u>	<u><u>\$(111,993)</u></u>

Xerium Technologies Inc.
Consolidating Balance Sheet
At December 31, 2011
(Dollars in thousands)

	<u>Parent</u>	<u>Total Guarantors</u>	<u>Total Non Guarantors</u>	<u>Other Eliminations</u>	<u>The Company</u>
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 11,548	\$ 280	\$ 31,738	\$ —	\$ 43,566
Accounts receivable, net	—	21,210	70,574	—	91,784
Intercompany receivable	(96,070)	102,739	(6,669)	—	—
Inventories	—	19,759	64,857	(1,299)	83,317
Prepaid expenses	272	2,354	3,551	—	6,177
Other current assets	—	3,910	11,141	—	15,051
Total current assets	(84,250)	150,252	175,192	(1,299)	239,895
Property and equipment, net	881	67,727	266,648	—	335,256
Investments	578,799	196,179	—	(774,978)	—
Goodwill	—	17,737	41,383	—	59,120
Intangible assets	11,484	6,985	4,171	—	22,640
Other assets	196	—	8,614	—	8,810
Total assets	<u>\$507,110</u>	<u>\$ 438,880</u>	<u>\$496,008</u>	<u>\$(776,277)</u>	<u>\$665,721</u>
LIABILITIES AND STOCKHOLDERS'					
(DEFICIT) EQUITY					
Current liabilities:					
Accounts payable	679	10,258	28,806	—	39,743
Accrued expenses	6,130	5,838	35,837	—	47,805
Current maturities of long-term debt	1,250	—	2,298	—	3,548
Total current liabilities	8,059	16,096	66,941	—	91,096
Long-term debt, net of current maturities	358,116	—	107,390	—	465,506
Deferred and long-term taxes	—	2,378	16,204	—	18,582
Pension, other post-retirement and post- employment obligations	22,906	1,820	56,462	—	81,188
Other long-term liabilities	—	—	11,654	—	11,654
Intercompany loans	187,661	(307,813)	120,152	—	—
Total Stockholders' (deficit) equity	(69,632)	726,399	117,205	(776,277)	(2,305)
Total liabilities and stockholders' (deficit) equity	<u>\$507,110</u>	<u>\$ 438,880</u>	<u>\$496,008</u>	<u>\$(776,277)</u>	<u>\$665,721</u>

Xerium Technologies Inc.
Consolidating Balance Sheet
At December 31, 2010
(Dollars in thousands)

	<u>Parent</u>	<u>Total Guarantors</u>	<u>Total Non Guarantors</u>	<u>Other Eliminations</u>	<u>The Company</u>
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 6,345	\$ 33	\$ 32,323	\$ —	\$ 38,701
Restricted cash	13,701	—	—	—	13,701
Accounts receivable, net	—	23,098	70,234	—	93,332
Intercompany receivable	(89,179)	107,756	(18,577)	—	—
Inventories	—	18,729	64,404	(1,206)	81,927
Prepaid expenses	360	1,390	3,358	—	5,108
Other current assets	700	1,898	13,515	—	16,113
Total current assets	(68,073)	152,904	165,257	(1,206)	248,882
Property and equipment, net	763	71,330	289,177	—	361,270
Investments	481,697	129,654	577	(611,928)	—
Goodwill	—	17,737	43,221	—	60,958
Intangible assets	1,561	9,417	1,980	—	12,958
Other assets	—	—	5,297	577	5,874
Total assets	<u>\$415,948</u>	<u>\$ 381,042</u>	<u>\$505,509</u>	<u>\$(612,557)</u>	<u>\$689,942</u>
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Notes payable	\$ —	\$ —	\$ 184	\$ —	184
Accounts payable	673	10,528	30,485	—	41,686
Accrued expenses	(1,090)	11,164	38,133	—	48,207
Current maturities of long-term debt	4,906	917	6,971	—	12,794
Total current liabilities	4,489	22,609	75,773	—	102,871
Long-term debt, net of current maturities	252,692	46,585	169,106	—	468,383
Deferred and long-term taxes	55	855	16,865	—	17,775
Pension, other post-retirement and post-employment obligations	7,779	6,764	55,103	—	69,646
Other long-term liabilities	—	—	12,532	—	12,532
Intercompany loans	210,013	(332,129)	122,116	—	—
Total Stockholders' (deficit) equity	<u>(59,080)</u>	<u>636,358</u>	<u>54,014</u>	<u>(612,557)</u>	<u>18,735</u>
Total liabilities and stockholders' equity	<u>\$415,948</u>	<u>\$ 381,042</u>	<u>\$505,509</u>	<u>\$(612,557)</u>	<u>\$689,942</u>

Xerium Technologies Inc.
Consolidating Cash Flow Statement
For the Year ended December 31, 2011
(Dollars in thousands)

	<u>Parent</u>	<u>Total Non</u> <u>Guarantors</u>	<u>Total Non</u> <u>Guarantors</u>	<u>Other</u> <u>Eliminations</u>	<u>Total Xerium</u> <u>Technologies, Inc.</u>
Operating activities					
Net income (loss)	\$ 8,190	\$ 37,300	\$ 21,976	\$(59,276)	\$ 8,190
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:					
Stock-based compensation	1,439	—	—	—	1,439
Depreciation	234	8,040	33,107	—	41,381
Amortization of other intangibles	—	2,212	93	—	2,305
Deferred financing cost amortization	56	204	2,047	—	2,307
Unrealized foreign exchange loss on revaluation of debt	—	—	139	—	139
Deferred taxes	—	—	336	—	336
Gain on disposition of property and equipment ...	3	(103)	(464)	—	(564)
Curtailed/settlement loss	—	—	402	—	402
Loss on extinguishment of debt	2,903	6	17	—	2,926
Provision for doubtful accounts	—	658	597	—	1,255
Undistributed equity in (earnings) loss of subsidiaries	(39,422)	(18,395)	—	57,817	—
Change in assets and liabilities which provided (used) cash:					
Accounts receivable	—	1,231	(2,103)	—	(872)
Inventories	—	(1,030)	(2,476)	93	(3,413)
Prepaid expenses	88	(155)	(238)	—	(305)
Other current assets	645	(1,296)	(521)	—	(1,172)
Accounts payable and accrued expenses	2,123	(1,854)	(4,089)	—	(3,820)
Deferred and other long-term liabilities	(211)	(1,053)	(4,062)	—	(5,326)
Intercompany loans	6,892	5,022	(11,914)	—	—
Net cash (used in) provided by operating activities	<u>(17,060)</u>	<u>30,787</u>	<u>32,847</u>	<u>(1,366)</u>	<u>45,208</u>
Investing activities					
Capital expenditures	(355)	(4,481)	(25,318)	—	(30,154)
Proceeds from disposals of property and equipment	—	146	7,618	—	7,764
Restricted cash	13,701	—	—	—	13,701
Other	1	—	—	—	1
Net cash provided by (used in) investing activities	<u>13,347</u>	<u>(4,335)</u>	<u>(17,700)</u>	<u>—</u>	<u>(8,688)</u>
Financing activities					
Net decrease in borrowings (maturities of 90 days or less)	—	—	(181)	—	(181)
Proceeds from borrowings (maturities longer than 90 days)	365,000	—	124,810	—	489,810
Principal payments on debt	(263,232)	(51,016)	(189,542)	—	(503,790)
Payment of deferred financing fees	(13,100)	—	(4,202)	—	(17,302)
Dividends (paid) received	—	—	(1,366)	1,366	—
Intercompany loans	(79,751)	24,812	54,939	—	—
Net cash provided by (used in) financing activities	<u>8,917</u>	<u>(26,204)</u>	<u>(15,542)</u>	<u>1,366</u>	<u>(31,463)</u>
Effect of exchange rate changes on cash flows	—	(1)	(191)	—	(192)
Net increase (decrease) in cash	5,204	247	(586)	—	4,865
Cash and cash equivalents at beginning of year	6,344	33	32,324	—	38,701
Cash and cash equivalents at end of year	<u>\$ 11,548</u>	<u>\$ 280</u>	<u>\$ 31,738</u>	<u>\$ —</u>	<u>\$ 43,566</u>

Xerium Technologies Inc.
Consolidating Cash Flow Statement
For the Year ended December 31, 2010
(Dollars in thousands)

	<u>Parent</u>	<u>Total Guarantors</u>	<u>Total Non Guarantors</u>	<u>Other Eliminations</u>	<u>The Company</u>
Operating activities					
Net (loss) income	\$ (73,086)	\$ 18,160	\$ (4,734)	\$ (13,426)	\$ (73,086)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:					
Stock-based compensation	7,310	—	—	—	7,310
Depreciation	323	7,821	30,819	—	38,963
Amortization of other intangibles	—	2,212	106	—	2,318
Deferred financing cost amortization	5,019	189	745	—	5,953
Unrealized foreign exchange gain on revaluation of debt	—	—	(1,621)	—	(1,621)
Deferred taxes	—	—	8,614	—	8,614
Asset impairments	—	122	2,768	—	2,890
Gain on disposition of property and equipment	—	(213)	(1,892)	—	(2,105)
Non-cash reorganization expenses	22,947	1,396	4,455	—	28,798
Reorganization expenses accrued	—	—	—	—	—
Non-cash interest expense related to interest rate swaps	4,630	4,097	994	—	9,721
Provision (credit) for doubtful accounts	—	(307)	(873)	—	(1,180)
Undistributed equity in (earning) loss of subsidiaries	(8,177)	4,666	—	3,511	—
Change in assets and liabilities which (used) provided cash:					
Accounts receivable	—	(6,389)	(3,259)	—	(9,648)
Inventories	—	(1,583)	(3,332)	104	(4,811)
Prepaid expenses	1,020	(600)	280	—	700
Other current assets	(813)	(553)	(708)	—	(2,074)
Accounts payable and accrued expenses	(3,745)	5,447	9,900	—	11,602
Deferred and other long-term liabilities	300	(623)	(1,287)	—	(1,610)
Intercompany loans	(4,042)	(12,172)	16,214	—	—
Net cash (used in) provided by operating activities	<u>(48,314)</u>	<u>21,670</u>	<u>57,189</u>	<u>(9,811)</u>	<u>20,734</u>
Investing activities					
Capital expenditures	(252)	(3,435)	(24,241)	—	(27,928)
Proceeds from disposals of property and equipment	—	296	3,874	—	4,170
Restricted cash	(13,701)	—	—	—	(13,701)
Other	—	—	(29)	—	(29)
Inter-company property and equipment transfers, net	—	(645)	645	—	—
Net cash used in investing activities	<u>(13,953)</u>	<u>(3,784)</u>	<u>(19,751)</u>	<u>—</u>	<u>(37,488)</u>
Financing activities					
Net decrease in borrowings (maturities of 90 days or less)	—	—	(1,025)	—	(1,025)
Proceeds from borrowings (maturities longer than 90 days)	60,000	—	402	—	60,402
Principal payments on debt	(10,098)	(595)	(17,697)	9,811	(18,579)
Other financing activities	(5,997)	(456)	(1,719)	—	(8,172)
Intercompany loans	17,481	(16,810)	(671)	—	—
Net cash provided by (used in) financing activities	<u>61,386</u>	<u>(17,861)</u>	<u>(20,710)</u>	<u>9,811</u>	<u>32,626</u>
Effect of exchange rate changes on cash flows	—	(92)	(118)	—	(210)
Net (decrease) increase in cash	(881)	(67)	16,610	—	15,662
Cash and cash equivalents at beginning of year	7,226	100	15,713	—	23,039
Cash and cash equivalents at end of year	<u>\$ 6,345</u>	<u>\$ 33</u>	<u>\$ 32,323</u>	<u>\$ —</u>	<u>\$ 38,701</u>

Xerium Technologies Inc.
Consolidating Cash Flow Statement
For the Year ended December 31, 2009
(Dollars in thousands)

	<u>Parent</u>	<u>Total Guarantors</u>	<u>Total Non Guarantors</u>	<u>Other Eliminations</u>	<u>The Company</u>
Operating activities					
Net (loss) income	\$(111,993)	\$(27,613)	\$(53,167)	\$ 80,780	\$(111,993)
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:					
Goodwill impairment	—	23,431	57,169	—	80,600
Stock-based compensation	2,305	—	—	—	2,305
Depreciation	299	8,229	31,011	—	39,539
Amortization of other intangibles	—	2,212	116	—	2,328
Deferred financing cost amortization	2,976	442	1,999	—	5,417
Unrealized foreign exchange gain on revaluation of debt	—	—	(1,626)	—	(1,626)
Deferred taxes	—	—	7,586	—	7,586
Asset impairments	—	542	1,127	—	1,669
Loss (gain) on disposition of property and equipment	—	90	(2,069)	—	(1,979)
Non-cash interest expense related to interest rate swaps	1,406	2,201	211	—	3,818
Provision (credit) for doubtful accounts	—	(2,346)	(2,618)	—	(4,964)
Undistributed equity in loss (earnings) of subsidiaries	66,724	25,651	—	(92,375)	—
Change in assets and liabilities which provided (used) cash:					
Accounts receivable	—	9,509	17,365	—	26,874
Inventories	—	(220)	12,906	40	12,726
Prepaid expenses	(812)	173	(43)	—	(682)
Other current assets	(1,228)	824	4,300	—	3,896
Accounts payable and accrued expenses	33	(1,930)	(47,089)	—	(48,986)
Deferred and other long-term liabilities	1,499	(147)	(1,749)	—	(397)
Intercompany loans	12,788	(13,303)	515	—	—
Net cash (used in) provided by operating activities	<u>(26,003)</u>	<u>27,745</u>	<u>25,944</u>	<u>(11,555)</u>	<u>16,131</u>
Investing activities					
Capital expenditures	(654)	(2,768)	(16,110)	—	(19,532)
Proceeds from disposals of property and equipment	—	6	4,255	—	4,261
Other	1,100	11,623	(11,623)	—	1,100
Intercompany property and equipment transfers, net	295	(46)	(249)	—	—
Net cash provided by (used in) investing activities	<u>741</u>	<u>8,815</u>	<u>(23,727)</u>	<u>—</u>	<u>(14,171)</u>
Financing activities					
Net decrease in borrowings (maturities of 90 days or less)	28,000	—	—	—	28,000
Proceeds from borrowings (maturities longer than 90 days)	—	—	163	—	163
Principal payments on debt	(9,801)	(2,079)	(29,423)	—	(41,303)
Other financing activities	(845)	(156)	(489)	—	(1,490)
Intercompany loans	4,913	(35,227)	30,314	—	—
Dividends (paid) received	—	—	(11,555)	11,555	—
Net cash provided by (used in) financing activities	<u>22,267</u>	<u>(37,462)</u>	<u>(10,990)</u>	<u>11,555</u>	<u>(14,630)</u>
Effect of exchange rate changes on cash flows	—	(125)	1,101	—	976
Net decrease in cash	(2,995)	(1,027)	(7,672)	—	(11,694)
Cash and cash equivalents at beginning of year	10,221	1,127	23,385	—	34,733
Cash and cash equivalents at end of year	<u>\$ 7,226</u>	<u>\$ 100</u>	<u>\$ 15,713</u>	<u>\$ —</u>	<u>\$ 23,039</u>

XERIUM TECHNOLOGIES, INC.
SCHEDULE II
VALUATION AND QUALIFYING ACCOUNTS
(dollars in thousands)

ALLOWANCE FOR DOUBTFUL ACCOUNTS

<u>Classification</u>	<u>Balance at Beginning of Year</u>	<u>Charged (credited) to Cost and Expense</u>	<u>Effect of Foreign Currency Translation</u>	<u>Deduction from Reserves</u>	<u>Balance at End of Year</u>
For the year-ended December 31, 2011:					
Allowance for doubtful accounts	\$ 4,755	\$ 1,255	\$(161)	\$ (617)	\$5,232
For the year-ended December 31, 2010:					
Allowance for doubtful accounts	\$ 7,370	\$(1,180)	\$(177)	\$(1,258)	\$4,755
For the year-ended December 31, 2009:					
Allowance for doubtful accounts	\$14,937	\$(4,963)	\$ 951	\$(3,555)	\$7,370

ALLOWANCE FOR SALES RETURNS

<u>Classification</u>	<u>Balance at Beginning</u>	<u>Charged to Revenue</u>	<u>Effect of Foreign Currency Translation</u>	<u>Deduction from Reserves</u>	<u>Balance at End of Year</u>
For the year-ended December 31, 2011:					
Allowance for sales returns	\$5,668	\$4,241	\$(148)	\$(4,762)	\$4,999
For the year-ended December 31, 2010:					
Allowance for sales returns	\$6,422	\$4,176	\$ 227	\$(5,157)	\$5,668
For the year-ended December 31, 2009:					
Allowance for sales returns	\$6,525	\$5,497	\$ 850	\$(6,450)	\$6,422

ALLOWANCE FOR CUSTOMER REBATES

<u>Classification</u>	<u>Balance at Beginning of Year</u>	<u>Charged to Revenue</u>	<u>Effect of Foreign Currency Translation</u>	<u>Deduction from Reserves</u>	<u>Balance at End of Year</u>
For the year-ended December 31, 2011:					
Allowance for customer rebates	\$1,217	\$ 975	\$ 8	\$ (935)	\$1,265
For the year-ended December 31, 2010:					
Allowance for customer rebates	\$1,432	\$ 602	\$(50)	\$ (767)	\$1,217
For the year-ended December 31, 2009:					
Allowance for customer rebates	\$1,620	\$1,008	\$ 82	\$(1,278)	\$1,432

EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description of Exhibit</u>
2.1(1)*	Joint Prepackaged Plan of Reorganization, as confirmed by the bankruptcy court on May 12, 2010.
2.2(2)	Confirmation Order, dated May 12, 2010.
3.1(3)	Second Amended and Restated Certificate of Incorporation of Xerium Technologies, Inc.
3.2(4)	Amended and Restated By-Laws of Xerium Technologies, Inc.
4.1(5)	Registration Rights Agreement by and among Xerium Technologies, Inc. and certain of its investors.
4.2(6)	Rights Agreement between the Company and American Stock Transfer & Trust Company, LLC, as Rights Agent, dated May 25, 2010.
4.3(7)	Registration Rights Agreement entered into by and among the Company and the RRA Parties, dated May 25, 2010.
4.4(8)	Form of Stock Certificate.
4.5(9)	Form of Warrant.
4.6(10)	Dividend Reinvestment Plan.
4.1(11)	Indenture among the Company, the guarantor parties thereto and U.S. Bank National Association as Trustee, dated May 26, 2011.
4.2(12)	Registration Rights Agreement among the Company, the guarantor parties thereto and the Initial Purchasers, dated May 26, 2011.
4.3(13)	Form of 8.875% Senior Notes due 2018 (included in exhibit 4.2).
10.1(14)	DIP Credit Agreement, dated April 1, 2010.
10.2(15)	Amended and Restated Credit Agreement among the Company and certain financial institutions as the Lenders, dated May 25, 2010.
10.3(16)	Exit Facility Credit Agreement among the Company and certain financial institutions as the Lenders, dated May 25, 2010.
10.4(17)	New Credit Facility among the Company, certain direct and indirect subsidiaries of the Company, and certain financial institutions, dated May 26, 2011.
10.5(18)	Director Nomination Agreement entered into by and among the Company and AS Investors, LLC, dated May 25, 2010.
10.6(19)	Director Nomination Agreement entered into by and among the Company, Carl Marks Strategic Investments, L.P., and Carl Marks Strategic Opportunities Fund, L.P., dated May 25, 2010.
10.7(20)+	2005 Equity Incentive Plan.
10.8(21)+	Amendment No. 1 to the 2005 Equity Incentive Plan.
10.9(22)+	Amendment No. 2 to the 2005 Equity Incentive Plan.
10.10(23)+	Amendment No. 3 to the 2005 Equity Incentive Plan.
10.11(24)+	Performance Criteria Terms for Performance-Based Awards Under the 2005 Equity Incentive Plan.
10.12(25)+	Form of 2008 Shareholder Return Based Restricted Stock Units Agreement under the 2005 Equity Incentive Plan.

<u>Exhibit No.</u>	<u>Description of Exhibit</u>
10.13(26)+	Form of 2008 Time-Based Restricted Stock Units Agreement under the 2005 Equity Incentive Plan.
10.14(27)+	Form of 2005 Performance-Based Restricted Stock Units Agreement for Executive Officers.
10.15(28)+	Form of 2005 Time-Based Restricted Stock Units Agreement for Executive Officers.
10.16(29)+	Form of Restricted Stock Units Agreement for Directors.
10.17(30)+	Xerium Technologies, Inc. Performance Award Program for 2009.
10.18(31)+	2009 Director Restricted Stock Units Agreement dated as of June 9, 2009.
10.19(32)+	2009 Director Restricted stock Units Agreement dated as of August 4, 2009.
10.20(33)+	2010 Equity Incentive Plan of Xerium Technologies, Inc.
10.21(34)+	Amendment No. 1 to 2010 Equity Incentive Plan of Xerium Technologies, Inc.
10.22(35)+	Performance Award Program for 2010.
10.23(36)+	Management Incentive Compensation Program for 2010.
10.24(37)+	2011 Management Incentive Compensation Program.
10.25(38)+	Long Term Incentive Plan.
10.26(39)+	2011-2013 Long-Term Incentive Plan.
10.27(40)+	Form of Time-Based Restricted Stock Units Agreement under the Long Term Incentive Plan.
10.28(41)+	Form of Independent Director Indemnification Agreement entered into between the Registrant and certain independent directors.
10.29(42)+	Form of 2010 Director Option Agreement.
10.30(43)+	Description of Compensation for Non-Management Directors.
10.31(44)+	Directors' Deferred Stock Unit Plan.
10.32(45)+	Amended and Restated Service Contract with John Badrinas.
10.33(46)+	Employment Agreement with Stephen R. Light.
10.34(47)+	Amendment No. 1 to Employment Agreement with Stephen R. Light.
10.35(48)+	Amendment No. 2 to Employment Agreement with Stephen R. Light.
10.36(49)+	Amendment No. 3 to Employment Agreement with Stephen R. Light.
10.37(50)+	2010 Performance-Based Restricted Stock Units Agreement with Stephen R. Light.
10.38(51)+	Stock Purchase Agreement with Stephen R. Light.
10.39(52)+	2008 Time-Based Restricted Stock Units Agreement with Stephen R. Light.
10.41(53)+	Amended and Restated Time-Based Restricted Stock Units and Performance-Based Restricted Stock Units Agreement with Stephen R. Light.
10.41(54)+	Employment Agreement with Clifford E. Pietrafitta.
10.42(55)+	Amended and Restated Employment Agreement with David Pretty.
10.43(56)+	Amendment to Amended and Restated Employment Agreement with David Pretty.

<u>Exhibit No.</u>	<u>Description of Exhibit</u>
10.44(57)+	Employment Agreement with Thomas C. Johnson.
10.45(58)+	Amendment to Employment Agreement with Thomas Johnson.
10.46(59)+	Employment Agreement with Eduardo Fracasso.
10.47(60)+	Employment Agreement with Kevin McDougall.
10.48(61)+	Amendment to Employment Agreement with Kevin McDougall.
10.49+	Employment Agreement with Donna Meserve.
10.50(62)+	Form of December 2011 Amendment to Employment Agreements with senior executive officers.
10.51(63)+	Agreement dated July 15, 2010 between Xerium Technologies, Inc. and AlixPartners, LLP.
21.1	Subsidiaries of the Registrant.
23.1	Consent of Ernst & Young LLP.
31.1	Certification Statement of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification Statement of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification Statement of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification Statement of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS(64)	XBRL Instance Document
101.SCH(64)	XBRL Taxonomy Extension Schema Document
101.CAL(64)	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF(64)	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB(64)	XBRL Taxonomy Extension Label Linkbase Document
101.PRE(64)	XBRL Taxonomy Extension Presentation Linkbase Document
(1)	Filed as Exhibit 2.1 to the Registrant's Quarterly Report on Form 10-Q filed on May 14, 2010, and incorporated herein by reference.
(2)	Filed as Exhibit 2.2 to the Registrant's Quarterly Report on Form 10-Q filed on May 14, 2010, and incorporated herein by reference.
(3)	Filed as Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on May 28, 2010, and incorporated herein by reference.
(4)	Filed as Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed on May 28, 2010, and incorporated herein by reference.
(5)	Filed as Exhibit 4.1 to the Registrant's Quarterly Report on Form 10-Q filed on June 23, 2005, and incorporated herein by reference.
(6)	Filed as Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on May 28, 2010, and incorporated herein by reference.
(7)	Filed as Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed on May 28, 2010, and incorporated herein by reference.

- (8) Filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on May 28, 2010, and incorporated herein by reference.
- (9) Filed as Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed on May 28, 2010, and incorporated herein by reference.
- (10) Filed as Exhibit 99.2 to the Registrant's Current Report on Form 8-K filed on February 20, 2007, and incorporated herein by reference.
- (11) Filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on June 2, 2011, and incorporated herein by reference.
- (12) Filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on June 2, 2011, and incorporated herein by reference.
- (13) Filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on June 2, 2011, and incorporated herein by reference.
- (14) Filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on April 2, 2010, and incorporated herein by reference.
- (15) Filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on May 28, 2010, and incorporated herein by reference.
- (16) Filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on May 28, 2010, and incorporated herein by reference.
- (17) Filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on June 2, 2011, and incorporated herein by reference.
- (18) Filed as Exhibit 10.5 to the Registrant's Current Report on Form 8-K filed on May 28, 2010, and incorporated herein by reference.
- (19) Filed as Exhibit 10.6 to the Registrant's Current Report on Form 8-K filed on May 28, 2010, and incorporated herein by reference.
- (20) Filed as Exhibit 10.7 to the Registrant's Quarterly Report on Form 10-Q filed on June 23, 2005, and incorporated herein by reference.
- (21) Filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on August 11, 2008, and incorporated herein by reference.
- (22) Filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on August 11, 2008, and incorporated herein by reference.
- (23) Filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on June 11, 2009, and incorporated herein by reference.
- (24) Filed as Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on August 11, 2008, and incorporated herein by reference.
- (25) Filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on January 7, 2008, and incorporated herein by reference.
- (26) Filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on January 7, 2008, and incorporated herein by reference.
- (27) Filed as Exhibit 10.9 to the Registrant's Registration Statement on Form S-1/A filed on May 3, 2005, Registration Number 333-114703, and incorporated herein by reference.
- (28) Filed as Exhibit 10.10 to the Registrant's Registration Statement on Form S-1/A filed on May 3, 2005, Registration Number 333-114703, and incorporated herein by reference.
- (29) Filed as Exhibit 10.11 to the Registrant's Registration Statement on Form S-1/A filed on May 3, 2005, Registration Number 333-114703, and incorporated herein by reference.
- (30) Filed as Exhibit 10.2 to the Registrant's Current Report on Form 10-Q filed on August 6, 2009, and incorporated herein by reference.
- (31) Filed as Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q filed on November 6, 2009, and incorporated herein by reference.
- (32) Filed as Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q filed on November 6, 2009, and incorporated herein by reference.
- (33) Filed as Exhibit 10.7 to the Registrant's Current Report on Form 8-K filed on May 28, 2010, and incorporated herein by reference.

- (34) Filed as Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q filed on August 9, 2011, and incorporated herein by reference.
- (35) Filed as Exhibit 10.8 to the Registrant's Current Report on Form 8-K filed on May 28, 2010, and incorporated herein by reference.
- (36) Filed as Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q filed on November 5, 2010 and incorporated herein by reference.
- (37) Filed as Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q filed on May 5, 2011, and incorporated herein by reference.
- (38) Filed as Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q filed on November 5, 2010 and incorporated herein by reference.
- (39) Filed as Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q filed on May 5, 2011, and incorporated herein by reference.
- (40) Filed as Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q filed on November 5, 2010 and incorporated herein by reference.
- (41) Filed as Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q filed on November 10, 2008, and incorporated herein by reference.
- (42) Filed as Exhibit 10.11 to the Registrant's Quarterly Report on Form 10-Q filed on August 13, 2010, and incorporated herein by reference.
- (43) Filed as Exhibit 10.7 to the Registrant's Quarterly Report on Form 10-Q filed on May 5, 2011 and incorporated herein by reference.
- (44) Filed as Exhibit 10.8 to the Registrant's Quarterly Report on Form 10-Q filed on May 5, 2011 and incorporated herein by reference.
- (45) Filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed on November 9, 2007, and incorporated herein by reference.
- (46) Filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on February 12, 2008, and incorporated herein by reference.
- (47) Filed as Exhibit 10.26 to the Registrant's Annual Report on Form 10-K filed on April 8, 2008, and incorporated herein by reference.
- (48) Filed as Exhibit 10.47 to the Registrant's Annual Report on Form 10-K filed on March 26, 2010, and incorporated herein by reference.
- (49) Filed as Exhibit 10.41 to the Registrant's Registration Statement on Form S-4 filed on December 22, 2011, and incorporated herein by reference.
- (50) Filed as Exhibit 10.48 to the Registrant's Annual Report on Form 10-K filed on March 26, 2010, and incorporated herein by reference.
- (51) Filed as Exhibit 10.49 to the Registrant's Annual Report on Form 10-K filed on March 26, 2010, and incorporated herein by reference.
- (52) Filed as Exhibit 10.27 to the Registrant's Annual Report on Form 10-K filed on April 8, 2008, and incorporated herein by reference.
- (53) Filed as Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q filed on November 5, 2010 and incorporated herein by reference.
- (54) Filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed on May 5, 2011, and incorporated herein by reference.
- (55) Filed as Exhibit 10.36 to the Registrant's Annual Report on Form 10-K filed on March 12, 2009, and incorporated herein by reference.
- (56) Filed as Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q filed on May 5, 2011, and incorporated herein by reference.
- (57) Filed as Exhibit 10.37 to the Registrant's Annual Report on Form 10-K filed on March 12, 2009, and incorporated herein by reference.
- (58) Filed as Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q filed on May 5, 2011, and incorporated herein by reference.
- (59) Filed as Exhibit 10.46 to the Registrant's Annual Report on Form 10-K filed on March 26, 2010, and incorporated herein by reference.

- (60) Filed as Exhibit 10.10 to the Registrant's Quarterly Report on Form 10-Q filed on August 13, 2010, and incorporated herein by reference.
- (61) Filed as Exhibit 10.6 to the Registrant's Quarterly Report on Form 10-Q filed on May 5, 2011, and incorporated herein by reference.
- (62) Filed as Exhibit 10.56 to the Registrant's Registration Statement on Form S-4 filed on December 22, 2011, and incorporated herein by reference.
- (63) Filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on July 20, 2010 and incorporated herein by reference.
- (64) Users of this interactive data file are advised pursuant to Rule 406T of Regulation S-T that this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.
- + Management contract or compensatory arrangement or plan.
- * The following exhibits to the Joint Prepackaged Plan of Reorganization were filed with the bankruptcy court, which, as permitted by Item 601(b)(2) of Regulation S-K, have been omitted from this Annual Report on Form 10-K. We will furnish supplementally a copy of any exhibit to the Joint Prepackaged Plan of Reorganization to the Securities and Exchange Commission upon request.

Exhibit A	Amended and Restated Credit Facility
Exhibit B	Commitment Letter
Exhibit C	New Management Incentive Plan
Exhibit D	New Warrants
Exhibit E	Executory Contracts and Unexpired Leases to be Rejected
Exhibit F	Amended and Restated Pledge and Security Agreement
Exhibit G	Austria Contribution Agreement
Exhibit H	Austria Note
Exhibit I	Austria Purchase Agreement
Exhibit J	Canada Direction Letter Agreement
Exhibit K	Exit Facility Credit Agreement
Exhibit L	Exit Facility Pledge and Security Agreement
Exhibit M	Germany Assumption Agreement
Exhibit N	Intercreditor Agreement
Exhibit O	Nominating Agreement
Exhibit P	Registration Rights Agreement
Exhibit Q	Restated Bylaws of each Reorganized Debtor
Exhibit R	Restated Charters of each Reorganized Debtor
Exhibit S	Shareholder Rights Plan
Exhibit T	U.S. Direction Letter Agreement
Exhibit U	Initial Directors and Initial Officers of the Reorganized Debtors
Exhibit V	Retained Actions
Exhibit W	Additional Intercompany Transactions

Board of Directors

Stephen R. Light
*President, Chief Executive Officer
and Chairman*

David A. Bloss, Sr.

Ambassador April H. Foley

Jay J. Gurandiano

John F. McGovern

Marc L. Saiontz

James F. Wilson

Corporate Headquarters

Xerium Technologies, Inc.
8537 Six Forks Road
Suite 300
Raleigh, NC 27615
Phone: (919) 526-1400
Fax: (919) 526-1430

Investor Relations Contact

Investor Relations
Xerium Technologies, Inc.
8537 Six Forks Road
Suite 300
Raleigh, NC 27615
Phone: (919) 526-1444
Email: ir@xerium.com

Annual Meeting

The Annual Meeting of Stockholders will be held on June 20, 2012 at 9 A.M., Eastern time, at our offices located at 8537 Six Forks Road, Suite 300, Raleigh, NC 27615

Executive Officers

Stephen R. Light
*President, Chief Executive Officer
and Chairman*

Clifford E. Pietrafitta
*Executive Vice President
and Chief Financial Officer*

Kevin McDougall
Executive Vice President, General Counsel

Joan Badrinas Ardèvol
*President – Europe Rolls and
Chief Technology Officer*

Thomas Johnson
President – Xerium Asia

David Pretty
*President – Xerium Europe PMC
and North America*

Eduardo Fracasso
President – Xerium South America

Donna Meserve
Vice President, Human Resources

Auditors

Ernst & Young LLP
Raleigh, NC

Market for Common Stock

Xerium Technologies, Inc.'s common stock is listed for trading on the New York Stock Exchange under the trading symbol "XRM".

Transfer Agent and Registrar

Wells Fargo Shareowner Services
P.O. Box 64874
St. Paul, MN 55164
Tel: (800) 468-9716 or
(651) 450-4064
www.shareowneronline.com

Forward Looking Statements

This annual report may contain forward looking statements that are not based on historical fact, including, without limitation, statements containing the words "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," "indicates," "suggests," and similar expressions. Because these forward-looking statements involve known and unknown risks and uncertainties, there are important factors that could cause actual results, events or developments to differ materially from those expressed or implied by these forward looking statements, including those factors identified in our annual report on Form 10-K for the year ended December 31, 2011, which is included herein, and in subsequent filings with the SEC. These factors should be considered carefully and readers are cautioned not to place undue reliance on such forward looking statements. Xerium Technologies, Inc. disclaims any obligation to update such forward looking statements.